

Economic crisis

# Fiscal crisis or a crisis of distribution? Squeeze the profits not the wages

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We are in a new episode of the global crisis: the struggle to distribute the costs of the crisis. This crisis has been an outcome of increased exploitation and inequality, since the post-1980s across the globe. Neoliberalism tried to solve the crisis of the golden age of capitalism via a major attack on workers. The outcome was a dramatic decline in worker's bargaining power and labor's share in income across the globe in the post-1980s.

However, the decline in the labor share has been the source of a potential realization crisis for the system. The decline in the purchasing power of workers limited their potential to consume. Demand deficiency and financial deregulation reduced investments despite increasing profitability. Thus neoliberalism only replaced the profit squeeze and over-accumulation problems of the 1970s with the realization problem. Financial innovations and debt-led consumption seemed to offer a short-term solution to this potential realization crisis. Since summer 2007 this solution has also collapsed. The crisis was tamed via major banking rescue packages and fiscal stimuli. Now the financial speculators and corporations are relabeling the crisis as a "fiscal" or "sovereign debt crisis" and pressurizing the governments in diverse countries ranging from Greece to Britain to cut spending to avoid taxes on their profits and wealth. The governments agreeing to the cuts are acting as if these same speculators were not the beneficiaries of decades long neoliberal policies and the main creators of the crisis. The public spending cuts are being formulated as "cutting the waste" and are obscuring the fact that public debt would not be there, if it were not for the bank rescue packages, counter-cyclical fiscal stimuli, and the loss of tax revenues due to the crisis. The pressure on wages associated with budget cuts is great news for the corporations! However the push for public debt reduction is the biggest threat to recovery. It is debatable where the recovery will come from, even if the bottom of the recession were reached, once the fiscal stimuli are withdrawn.

## Wage suppression, global imbalances and Europe

The realization crisis at the origin of the crisis based on wage suppression was deeply connected to global imbalances. The debt-led consumption model generated a current account deficit in countries like US and Britain. This deficit was financed by the surpluses of developed countries such as Germany and Japan, developing countries like China and South Korea, or the oil rich Middle Eastern nations. In most cases current account surpluses were made possible by wage suppression.

In the European context, the wage suppression strategy and current account surpluses of countries

like Germany were matched with current account deficits, public or private debt in the periphery of the Euro Zone, in particular in Greece, Portugal, Spain, and Ireland or in Eastern Europe, in particular in Hungary, Baltic States, Romania, and Bulgaria, and also in some core countries like Britain and Italy. The crisis laid bare the historical divergences within Europe, and now transformed the global crisis into a European crisis.

The crisis once again showed that the EU with its current institutions is a union of banks and corporations. The European Central Bank (ECB), who acted as a lender of last resort to the private European banks, did not fulfill the same function in the case of the Euro zone governments due to its legal statute. ECB is forbidden to buy government bonds of the member states directly. The banks were not only bailed out by the ECB, but also the macroeconomic environment in which they are operating was supported by counter-cyclical expansionary fiscal policy to prevent the recession turning into a great depression. Now it is again the same banks who are asking for high interest rates against the default risk of the governments with high budget deficits and public debt and threatening to stop lending to the governments who fail to reduce the risk of default.

In countries like Greece where both public debt and budget deficit are high and coupled with a high current account deficit, the attack of the speculators has brought the country to the edge of a sovereign debt crisis. Indeed before Greece, in 2009 Eastern European countries were under attack. After Greece, attention soon turned to Portugal and Spain.

At the root of the problem is the neoliberal model that turned the periphery of Europe to markets for the core countries without any prospect of catching up. The lack of a sufficiently large European budget and significant fiscal transfers targeting productive investments in the periphery prevented convergence in productivity with respect to the core. Stability and Growth Pact as well as EU competition regulations limited the implementation of national industrial policy. In the absence of industrial policy and productive investments to boost productivity and unable to increase their relative competitiveness by devaluing their currency after the adoption of Euro, the strategy of competitiveness was based mainly on wage moderation, and increased deregulation and precarization in the labor markets. However, wage moderation also did not save countries like Greece, Portugal, Ireland, Spain, since Germany was engaged in a much more aggressive wage and labor market policy. Overall, labor's share in income declined sharply in Europe.

Between 2000-2007 nominal unit labor costs declined by 0.2% a year in Germany while raising by 2% in France, 2.3% in Britain, between 3.2% and 3.7% in Italy, Spain, Ireland, and Greece. In particular in the periphery nominal labor costs have increased faster than in Germany due to a higher rate of inflation. This however does not mean that there was no wage moderation in these countries: in the 1990s and 2000s productivity increases exceeded changes in real wages in all Western EU countries. In Germany as well as in Italy, Spain, and Portugal real wages even declined in the 2000s, with the gap being largest in Germany. The phenomenal competitive advantage of Germany was simply due to wage suppression rather than increasing productivity. Indeed the productivity increase in Germany has been quite modest; e.g. lower than in Britain, Ireland, Greece, and Portugal in the period of 1991-2007.

With weak domestic demand due to low wages, exports were the main source of growth in Germany, but this has led to the current account surpluses at the expense of the current account deficits in the periphery of the EU. Indeed Germany is like the China of Europe with large current account surplus, high savings and low domestic demand. In the countries of the periphery consumption led by private debt has filled in the gap that low exports and high imports have created. In Greece and to a lesser extent Portugal fiscal deficits also increased along with the debt of the households and corporations.

This is the background of the sovereign debt crisis in the periphery, as it was unleashed in Greece in

December 2009. Following speculations about Greece's default and exit from the Euro zone, the Euro zone governments' decision to deal with the crisis in Greece came at the end of March 2010 after months of hesitation and worries about Germany's constitution court, who could rule out any bailout as being against the treaties. As part of a package involving substantial IMF financing and a majority of European financing via coordinated bi-lateral loans, Euro area member states declared their readiness to support Greece. Any disbursement is subject to severe cuts based on an assessment by the European Commission and the ECB. The loan will only be made available, if Greece cannot borrow in the financial markets, and interest rate will be at a penalty rate. However the speculators are aware that this is not a solution to Greece's insolvency problem and find the amount insufficient to avoid a default. In April 2010, as the IMF and the Eurozone technocrats were bargaining the conditions of the credit, the interest rate of the two-year government bonds increased to almost 15% and Greek bonds were downgraded to junk status. The contagion started to threaten Spain and Portugal, whose bonds were also downgraded slightly; in Ireland the interest rates on bonds increased and eyes turned to the sovereign debt problem in the core countries like Italy, Belgium, Britain, and even the US. The later increase in the amount of the package will only postpone the problem. EU does not question the reasons behind the deficits; it ignores all the structural problems regarding divergence in productivity, imbalances in current accounts due to the "beggar my neighbor" policies of Germany. Unexpectedly, the original €30 billion bailout package planned by the Eurozone governments is estimated to be roughly the amount the European Banks, most of which are based in Germany and France, would be losing on their holdings of the Greek government bonds, if Greece had to restructure its debt (The Economist, 2010a); thus the Eurozone governments are indeed bailing out their own banks. Under the pressure of the banks' speculation the initially spelt amount turned out to be the first part of a larger 3-year package.

The role model pointed out by the EU politicians for Greece was Ireland: Ireland has already smashed public sector wages between 5-15%, cut social welfare and other spending in order to decrease its budget deficit from 12.5% in 2009 to 2.9% in 2014. These brutal spending cuts in Ireland have been praised since they have restored market confidence without aid from the EU. However this did not prevent the speculators from asking higher interest rates on Irish bonds after the contagion effects of the crisis in Greece. The other role model celebrated for its self-discipline has been Latvia, who has managed a real devaluation not by abandoning its pegged exchange rate, but by deep cuts in wages and public spending, at the cost of 25.0% loss of GDP in two years and 22.9% unemployment in 2009.

Greece is now pushed to cut its budget deficit from 13.6% of GDP in 2009 to 3% in 2013 via dramatic cuts in spending, public sector wages, increase in retirement age, tax hikes, sale of public land, and a fight against tax evasion -the only correct thing in the package. The bulk of the austerity measures will hurt the working people. However it is unclear how the austerity plan will rescue Greece from insolvency: as the recession becomes deeper, tax revenues will become lower and despite severe cuts, budget deficit might not improve. The high interest rates are also increasing the problem of insolvency further. The Economist (2010b) estimates that nominal GDP of Greece will be 5% lower by 2014, if it is to reduce its budget deficit to 2.6% of GDP by 2014, which would however still mean a debt to GDP ratio of 153%.

Outside the Euro zone, Britain is another major plot of race between the mainstream parties on how and when to reduce the budget deficit. Although the deficit is one of the highest in the EU with a ratio of 11.7% to GDP in 2009, the whole buzz about Britain's public debt is surprising when one considers that average maturity of the debt is 13.7 years, the interest rate is at historical lows, and the ratio of debt to GDP is 68.6%. Moreover part of the increase in the public debt to GDP ratio is because of a lower GDP. Since the end of 2009 the recession has turned into stagnation; public sector cuts at this stage would turn stagnation into a double dip recession. The presumed positive

effect of reduced budget deficit on private investments is based on the argument that lower government borrowing leads to lower interest rates and a higher private investment and consumption. Under the current conditions where consumers are trying to reduce their debt, investments are postponed due to uncertainty about the recovery and interest rates are already low, this channel has no relevance. Decline in income and confidence, job losses, the pressure to pay back debt is restraining household consumption. Both investments and consumption will not return back to normal even when the banks relax credit. Under these circumstances the talk about a fiscal crisis looks more like an excuse of the business lobbies to avoid tax increases to finance the budget deficit, and make the wage earners pay the costs of the crisis through cuts in income, jobs, and social services, and to create a situation of “national emergency” to smash the remaining power of the trade unions in the public sector.

The austerity packages throughout the EU are pushing the countries into a model of chronically low internal demand. The deflationary consequences of wage cuts may turn the problem of debt to insolvency for private as well as the public sector. In the past in Germany low domestic demand was substituted by high demand for exports. But it is not possible to turn the whole Europe into a German model based on wage suppression and austerity, since without the deficits of the others German export market will also stagnate. As the world’s periphery comes out of the recession, this demand can help the exporters of Germany for some time, but not every country can be the winner in this game. Particularly for the periphery of Europe contracting domestic demand means prolonged stagnation or even recession, which is neither economically nor politically stable.

Real wages have already declined in 2008-09 compared to 2007 in Britain, Germany, Italy, Sweden, Hungary, the Baltic Countries, and Romania. Ireland, Greece, Portugal, and Spain are preparing for severe real wage cuts in 2010. Sharp and long-lasting increases in unemployment are likely to make the wage losses much stronger. Unemployment has increased in 2009 by 1.9%-points in the Euro area, 2.3%-points in Britain. Particularly high increases took place in Ireland and Spain (6.0 and 6.7%- points respectively) due to the collapse of the construction sector and loss of temporary jobs. Unemployment is expected to increase further and display a significant persistence. Firms might want to make use of the recession to rationalize a strategy of increasing productivity and start a new wave of firing or engage in hiring freezes long after the recovery. If firms increase the working hours and delay hiring, this would worsen the job chances of the unemployed and the young first time job seekers. The crisis then will lead to an increase in long term unemployment as well as discouraged workers who drop out of the labor market. There are also structural problems of unemployment in sectors like automotive industry and construction, where the crisis only uncovered the already existing bottlenecks. Recovery of the aggregate economy will not necessarily create jobs in these sectors.

### **For an internationalist Europe!**

Although the costs of the rescue packages are clear, no effort is being made to make the responsible and the wealthy pay the costs. The tax on bank bonuses in Britain only targets a small dimension of the problem. The economic crisis is intermingled with the ecological crisis, and showing that capitalism is economically, ecologically, and politically unstable and unsustainable. The struggles emerging all over Europe can be turned into a leverage for developing an internationalist alternative to the crisis in Europe. The existing wage suppression policies of the different EU countries have hurt the working people of these countries alike. The popular argument in Germany that Greece has a public spending crisis is hiding the point that it is the German workers’ loss of wages, unemployment benefits, and pension rights in the last decade, which has created an important part of the imbalances in Europe.

Uncovering this truth is an important step towards building a working peoples' alliance for an alternative Europe. An internationalist solution might generate a more powerful front in the core and the periphery compared to national alternatives, e.g as suggested by Lapavistas and colleagues (2010) for Greece based on exit from the Euro and an anti-capitalist agenda. A national solution in a small country is destined for isolation and a long term persistence of the problems of underdevelopment. Moreover, tactically speaking, in the current situation in Europe, anti-European and anti-Euro policies are more likely to mobilize nationalist, right-wing mobilization than a pro-labor anti-capitalist strategy.

The left strategy has more to gain from an internationalist alternative.

The major crisis calls for a major policy restructuring in the direction of a democratically planned, participatory socialist economic model and the starting point is the urgent problems of employment, distribution, and ecological sustainability:

- public employment in public transport, insulation of the existing housing stock, building zero energy houses, renewable energy, education, child care, nursing homes, health, community and social services
  - a substantial shortening of working time (in parallel with the historical rate of growth of labor productivity) without income losses for the workers to achieve full employment at a low growth rate consistent with the carbon emission targets
  - firing freeze and wage floors in the private firms, re-appropriation of the bankrupt firms under workers' control supported by public credits.
  - a minimum wage coordinated at the EU level
  - a European unemployment benefit system to redistribute from low to high unemployment regions
  - an EU budget at the level of 5% of EU GDP financed by EU level progressive taxes.
  - tax coordination for higher and progressive corporate tax rates, inheritance tax, wealth and income taxes with the highest marginal tax rate increasing to 90% above an income threshold, which corresponds to the income of the richest 1% of the population
- a progressive wealth tax on the stocks of government bonds with the highest marginal tax rate reaching to 100% above a certain threshold to restructure the public debt
- abolish the Stability and Growth Pact;
  - turn the ECB into a real central bank with the ability to lend to member states as well as European Bank for Reconstruction and Development;
  - nationalize the banking sector and other key sectors such as energy, transport, housing, education, health, social security under democratic participation and control of the workers and the stakeholders (consumers, regional representatives etc.);
  - capital controls within and across the borders of Europe.

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