The Pavia Declaration: A New Deal for a Social and Democratic Europe

Prologue

The Pavia Group's April 2015 meeting took place against the background of a deepening European economic crisis.

The Eurozone crisis has many causes and culprits. However only its citizens are being asked to pay the burden of its costs, especially those in the European periphery. Austerity in Greece and other member states has been submitted to dictates from a Troika of the European Central Bank (ECB), European Commission and International Monetary Fund (IMF) and is contributing to massive hardship which prejudices the commitment of the Rome Treaty to rising standards of living and of its first revision in the Single European Act to economic and social cohesion.

"Europe is not working" either in the sense of assuring high levels of employment or in terms of the commitment to democracy of its founders.

'Structural reforms' that induce austerity while reducing social protection cannot be the condition of any assistance to debt distressed countries. The IMF in its April 2015 World Economic Outlook recognizes that employment protection is not found to have any statistically significant negative effect on productivity. An obsession with reducing debt neglects that Europe could allocate surplus savings into productive investments especially because increased public investment raises output both in the short and long term, crowds in private investment, and reduces unemployment with limited effect on the public debt ratio, as supported by the IMF paper (written by A. Abiad, D. Furceri, and P. Topalova) of May 2015.

If the European Union is both to survive and flourish it needs to reassure its citizens that markets serve people rather than people serve markets, as well as that its institutions are working in their interest and adding value to what its member states otherwise cannot do as well by themselves. For some analysts this can only be achieved by new federal institutions, similar to those of the US. But Europe cannot wait for this. Without alternatives now it risks disintegration.

This is the main reason why this Declaration stresses feasible alternatives now. Europe already has the institutions and the decision-making procedures that could enable a recovery of investment and jobs. One of these is the European Investment Bank (EIB), whose lending for investments does not count on the debt of member states. Neither is there any need for national guarantees, for fiscal transfers, or for a "transfer union", since EIB bonds are serviced from project finance.

Those governments that want a recovery in employment have the power to act through the procedure of 'enhanced cooperation', which does not require unanimity, and which could by-pass entrenched opposition by a few member states to a bond-funded investment-led European recovery.

Supply side measures that reduce labour costs neglect the resulting reduction in aggregate demand, while in contrast supply side investment programmes can create aggregate demand.

Investment creating demand was the basis of the success of the Roosevelt New Deal in the 1930s, whereas after the crisis of 2007-2008 many EU member states have committed themselves to balanced budgets. Since then, the risk of depression and persistent unemployment and poverty in key member states and many European regions has mainly been the consequence of European austerity policy, whereas in other world regions and large economies policies have been either investment-led (East Asia) or demand-led (the USA).

The current trends in Europe are decreasing the ratios of labour income and investment to GDP. As an outcome, the crucial missing variable is the lack of aggregate demand. This reflects a private sector investment that still is a sixth below its pre-crisis level.

In European documents there is often an excessive emphasis on export-led growth. But in a large market such as that of the EU, internal demand is often more important than external demand. EU member states trade mainly with themselves. The ratio of extra-European exports to GDP was lower than 10% before the economic crisis and the EU as a whole is broadly in balance with the rest of the world. There is, instead, a vast latent demand for social investments and employment and income generated by these, such as in health, education, urban regeneration and safeguarding the environment.

Great structural economic differences among European countries and regions already existed at the time when the single European currency was introduced. These could not have been eliminated by uniform financial rules in Europe. Such differences increased during the crisis, and backward regions need specific productive investment programs. Structural differences between European countries and regions cannot be eliminated by reducing wages in an attempt to increase price competitiveness, nor by low level Structural Funds. They need a rediscovery of industrial, innovation and regional policies that foster structural competitiveness.

Quantitative easing has been necessary, but it is not sufficient for European economic recovery. This has been recognised by Mario Draghi who has stressed that it is governments that need to act to promote an investment-led recovery. Although bond finance of European investment is ruled out for the ECB, it has been the basis of EIB investment funding since 1958. This can be the key to recovery.

A Decalogue to resolve the European Crisis

The current crisis can be resolved without new financial institutions, without Treaty revisions, without fiscal transfers between member states and without national guarantees for bond-funded investments.

1. A “New Deal for Europe” is feasible through bond-financed social and environmental investments and development projects similar to the Roosevelt New Deal but not needing a fiscal union since bonds, as in the case of the EIB, can be serviced by revenues from national governments which will increase with a recovery of investment and employment.
2. Europe could and should recycle global surpluses. The BRICS made plain in Washington in September 2014 that they would invest in Eurobonds if the EU were to issue them to finance a recovery. Sovereign wealth funds – and pension funds – have vast surpluses for which they struggle to find adequate investment outlets.
3. There should be a major increase of direct European investment, based on borrowing from the EIB and its sister institution the European Investment Fund (EIF) with the under-recognised advantage that borrowing from them does not count on national debt. The proposal for a European Fund for

Strategic Investment (EFSI) and to define investment criteria for this neglects that no new investment criteria are needed for a bond funded investment recovery since the criteria for the EIB already include Trans-European Transport and Communications Networks (the TENs) and support for small and medium firms as well as investments in health, education, urban regeneration, green technologies and protection of the environment (cf. Essen European Council, December 1994, and Amsterdam Special Action Programme of 1997).

4. There have been various proposals to mutualise national debt up to or in excess of the Maastricht debt limit of 60% of GDP. The proposal to do so above this level is subject to "moral hazard", whereas doing so up to the 60% limit is not. This could readily be converted into "Union Bonds" which, like the *Erblastentilgungsfond* of the Federal Republic on German reunification, are not traded nor used to leverage financial derivatives and speculation. The interest to service such bonds would be the liability of national governments from direct and indirect fiscal receipts generated by the recovery of investment, employment and incomes and would not need fiscal transfers between them.
5. The "golden rule" principle that, over an economic cycle, a government will borrow only to invest, rather than to finance current spending, should be adopted in interpretation of the Stability Pact. This should exclude public investment and national and regional co-financing of European financed projects from the Stability Pact's indicators.
6. An effective European Development Strategy was set out in the 1993 Delors White Paper on *Growth, Competitiveness and Employment*, which also proposed the European Investment Fund. Its vision of the future opportunities for European economy and society was unanimously endorsed by the Essen European Council of 1994 and needs to be recovered now. Bond finance from the EIB and EIF should enable synergies between research, development and restructuring of key sectors - green and alternative energy, green European transports, territory care, research on health, aerospace (as in the existing European Industrial Policy) - and should increase attention on the needs of European citizens. Public policy can help to extend, create and co-create markets and support business ecosystems and clusters, in mutually beneficial collaboration with the private sector, while respecting sustainability concerns, for the society and its own enlightened self interests.
7. There should be a resolution of insolvent banks through existing European procedures and institutions. The ECB and the European Stability Mechanism can restructure, recapitalise and resolve exposed banks on a case-by-case basis, without waiting for a fully-fledged Banking Union.
8. Existing financial resources at regional and local levels can be reinforced by issuing territorial and district bonds, creating stronger linkages between local financial resources and investment needs, and between collective share capital at local levels and support for management and worker buy-out initiatives through a regionalised European venture capital fund financed by European Investment Fund (EIF) and EIB bonds.
9. The capabilities of local and regional actors should be reinforced through local development projects funded by joint EIB-EIF European bond finance. This would enable a "resurgence" of local and regional capabilities, responding to community needs on the basis of public and social entrepreneurship and trans-regional and trans-national co-operation programmes, which have already been accepted in principle by the EU since the launch of the RECITE (Regions and Cities of Europe) programme in 1988.
10. With gains in direct and indirect fiscal receipts from recovery of employment and output, resources would be generated for a European Solidarity Programme to offset extreme poverty by guaranteeing a minimum European citizenship social standard. In the short term this could be

funded from the interests accumulated within the European system of central banks (TARGET2 - Trans-European Automated Real-Time Gross Settlement Express Transfer System).

None of this excludes an increase of the European budget and a transition in due course towards European fiscal policy financed by the introduction of European carbon taxes, a Financial Transaction Tax, and a fair European tax on the profits of Multinational Enterprises or the harmonisation of European taxes on profits, avoiding fiscal competition among state members. But none of it depends on this. While support in due course for such a common fiscal policy would be reinforced by European governments showing that they can recover high levels of investment, employment, trade and wellbeing.

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