



7 June 2010

**A Progressive way out of the Crisis**  
**Recovery vs. Austerity: PES strategy to resolve the dilemma**

**Draft PES Policy Paper<sup>1</sup>**

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<sup>1</sup> This draft Policy Paper is under discussion and does not necessarily represent the view of the PES and its member parties.

## Executive Summary

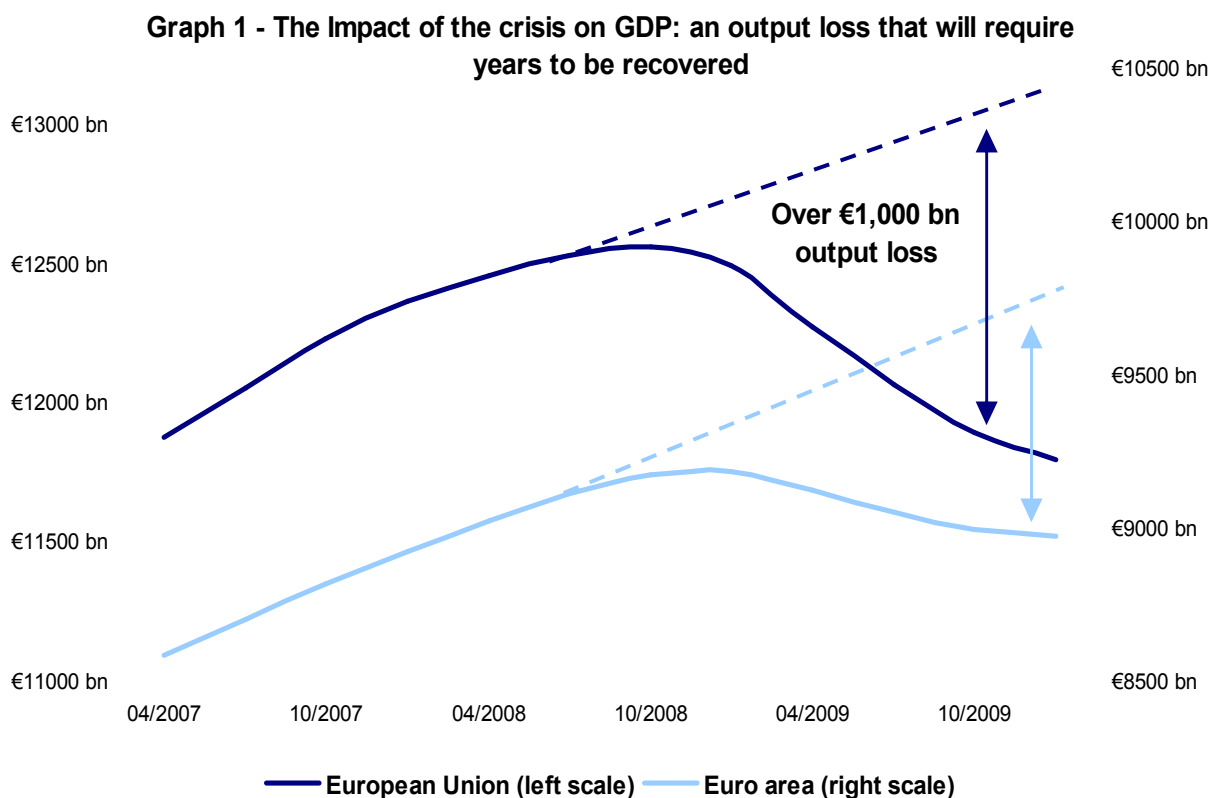
- **The financial, economic and employment crisis has resulted in a policy environment constrained by both the necessity to kick start Europe's productive engine and to consolidate public finances.** It is not just a cyclical downturn; it is a crisis of the system, caused by deregulation and neo-liberal policies. Having caused 7 million EU workers to lose their jobs, increasing inequalities, rising poverty and the destruction of €1000bn worth of output, the crisis has also emptied the governments' chests, as public indebtedness has increased by €3000bn since the onset of the crisis. **Our governments are facing a major challenge: to spend while also saving.**
- Faced with this dilemma, Conservatives across Europe have presented a united front, unexampled anywhere else in the world. They have consistently been calling for an "exit strategy" (i.e. to immediately engage in fiscal consolidation strategies), irrespectively of the likely negative outcome regarding growth, jobs and the financing of the welfare states. **To a complex question, the Conservatives' answer could not be simpler: cuts, cuts, cuts.**
- **But there is another way, based on a sensible progressive approach, to achieve both economic recovery and long-term sustainability of public finances.** This approach is based on four immediate policy actions:
  1. **To protect governments' access to finance from speculation** through the establishment of a "European Mechanism for Financial Stability";
  2. **To raise new, fair and sustainable revenue through unexplored fiscal and non-fiscal sources**, first and foremost a tax on financial transactions, but also fair green taxes as well as a redefined use of EU structural funds and European Investment Bank' loans, and creating Eurobonds to finance long-term investments;
  3. **To make economic recovery and sustainable growth the core objective of public policies**, which requires, in particular, to extend the deadlines of the Excessive Deficit Procedures of the Stability and Growth Pact and to prioritise public spending;
  4. **To make fiscal policies more efficient by enhancing European coordination**, notably in the euro-zone.

## 1. Why do we need to rethink public policies?

The current policy environment in the European Union is greatly constrained by the economic, financial, employment and social crisis that was triggered by the near collapse of the financial markets in the summer of 2007. This is not just a cyclical downturn, it is also a systemic crisis. Several decades of neo-liberal policies and deregulation have resulted in weaker economic structures that now must be reinforced. The crisis has resulted in a huge drop in the level of output – the largest recession witnessed in Europe since the Second World War – and a tremendous increase in unemployment, inequality and poverty.

By the end of 2010, the GDP of the EU will still be almost €500 billion below its 2008 level. Had the recession not occurred, and our economy continued to grow at pre-crisis pace, the level of GDP in Europe would be €500 billion more in 2010. On this scale, **the crisis has already cost us €1000 billion worth of goods and services**, or €2000 per citizen (see graph 1).

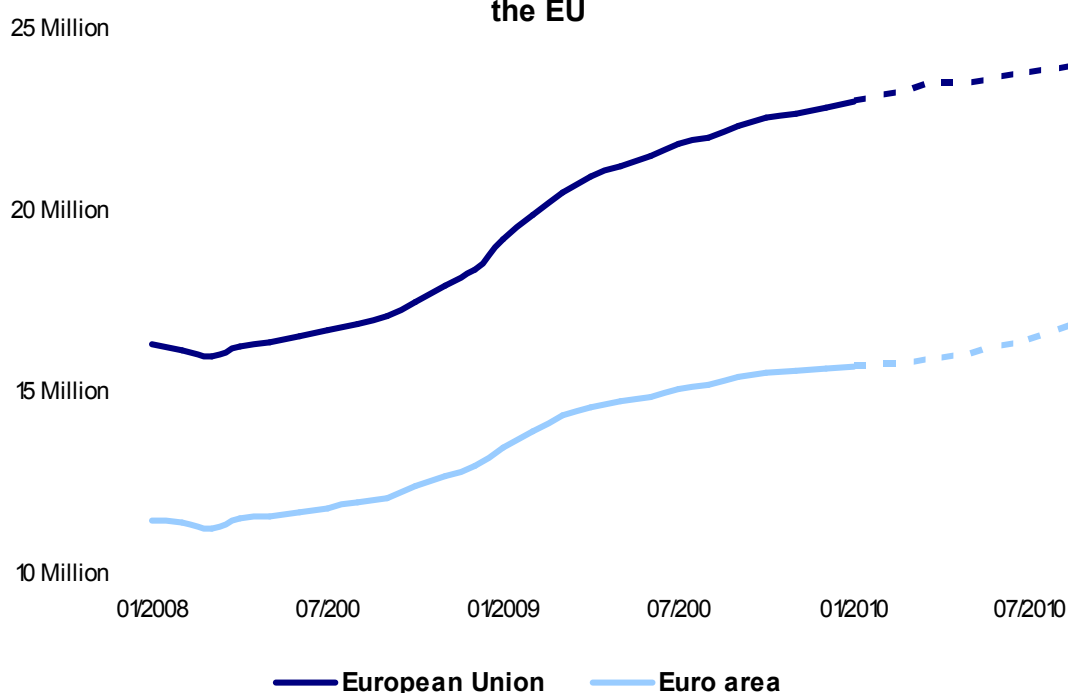
On top of this, no one can yet say the recession is over. **In annual terms, GDP growth is still negative.** A very modest rebound was recorded in the third quarter of 2009, at 0.4%; but recently released figures for the fourth quarter of 2009 and the first quarter of 2010 showed a significant slowdown (+0.1% and 0.2%, respectively) which illustrate the fragility of the ‘recovery’.



data source: Eurostat

By destroying production, **the crisis is also destroying jobs: 7 million so far** and still counting. By the end of 2010, another million is likely to be added to the unemployment count, corresponding to a total of **over 23 million unemployed** people in the European Union (see graph 2). This does not only threaten social cohesion and weaken the competitiveness of Europe's economy, but also increases the pressure on public budgets. Moreover, the poor economic performance and the rising unemployment lead to increasing poverty levels and more social exclusion.

**Graph 2 - Unemployment: the sharpest increase ever recorded in the EU**



*data source: Eurostat*

Furthermore, because governments had to intervene massively to rescue the financial system and the real economy from complete collapse, the crisis has resulted in a record increase in public debt, unprecedented since the 1930's. **By the end of 2011, average public debt in the EU will be well above 80% of GDP, over 20 percentage points more than in 2008.** This increase amounts to €3000 billion, or €6000 per person.

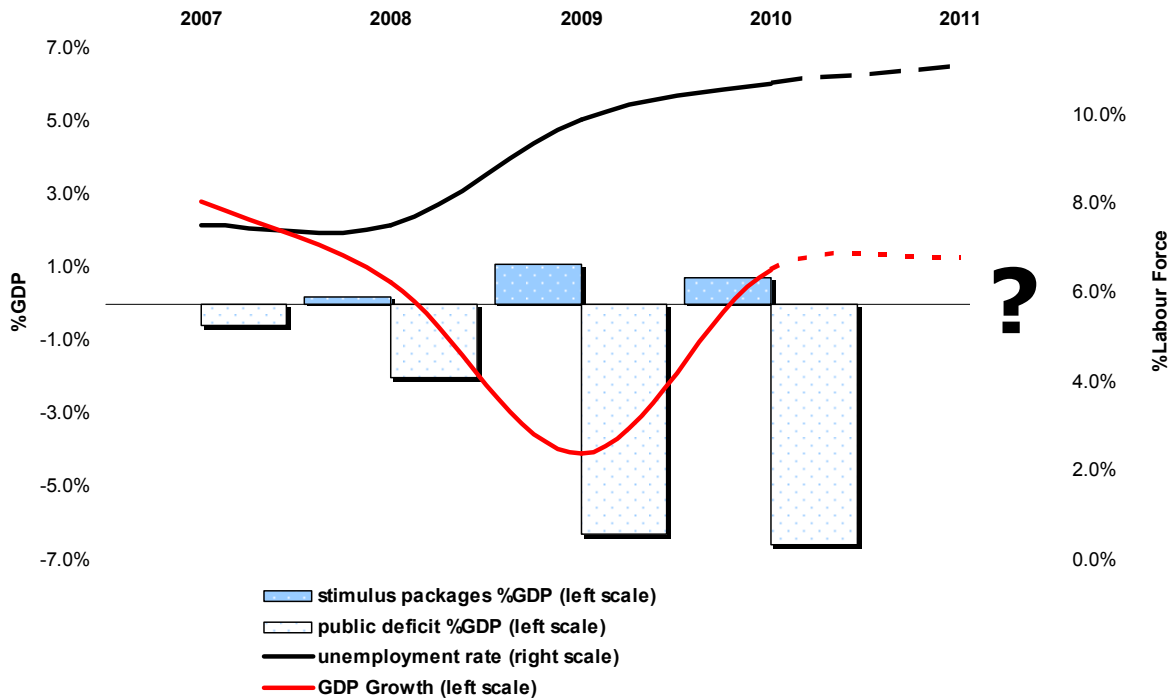
In 2007, nearly half of the EU Member States had positive public balances; today, all record deficits. The EU will have to cope with yearly average deficits in excess of 6% of GDP – that is twice the limit of the Stability and Growth Pact (SGP) – for at least another two years (see graph 3). The transfer of debt from the private to the public sector has had a major impact on the conduct of governments' daily business; the **service of the debt has jumped by 13% in 2 years**, and is set to increase further.

### (i) The Dilemma

On the one hand, our economy is not yet out of the crisis. Growth prospects are gloomy, and the risk of a double-dip into recession cannot be fully dismissed. Our only certainty is that the situation is set to deteriorate further on the labour market. This calls for prolonged involvement of the State in supporting the economy through expansionary fiscal policies. **Any withdrawal of fiscal stimulus now would be detrimental to both growth and jobs** and would undermine the automatic stabilizers<sup>2</sup> from our public sector as well as our welfare states.

<sup>2</sup> Automatic stabilizers are the non-discretionary part of the fiscal measures provided by the States, which act as a buffer to the economic cycle. For instance, in times of a recession social transfers increase automatically because unemployment is higher. This automatic increase provides in turn fiscal stimulus, notably in supporting private consumption.

Graph 3 - Macroeconomic performances of the Euro-zone and Fiscal Policy



data source: European Commission

On the other hand, the fact that our welfare states' automatic stabilizers have functioned and that governments have already spent billions of euro in bailing out banks and counter-acting the crisis, has led to substantial increases in deficits and debts.

But the financial markets have not accepted this development. Now, once again, they are putting pressure on the EU Member States with soaring interest rates on sovereign debt for all and speculative attacks on a selected few.

In this situation, the reaction from Conservative finance ministers is to call for fiscal consolidation strategies to be implemented without delay. They argue that continued fiscal expansion would drive Europe to the verge of sovereign default. We believe such a reaction would kill the recovery before it even starts. Furthermore, tightening fiscal consolidation would enforce cuts in the social security systems and therefore weaken our automatic stabilizers, with negative effects on social coherence and the labour market.

In fact, it is only in Europe where demands for an "exit strategy" are voiced. **Most of Europe's major trading partners are still pursuing expansionary economic policies<sup>3</sup>.**

## (ii) Their Way – a single-minded austerity dead end

<sup>3</sup> For instance, the USA will have implemented a 1.8% fiscal stimulus in 2010 according to the IMF. The 2011 budget plans for the extension of recovery measures, such as tax support for middle-income households, as well as additional measures such as the doubling of the "Child and Dependent Care Tax Credit". Japan has also adopted an additional recovery package for 2010, representing 5% of GDP, according to the Japanese Ministry of Finance.

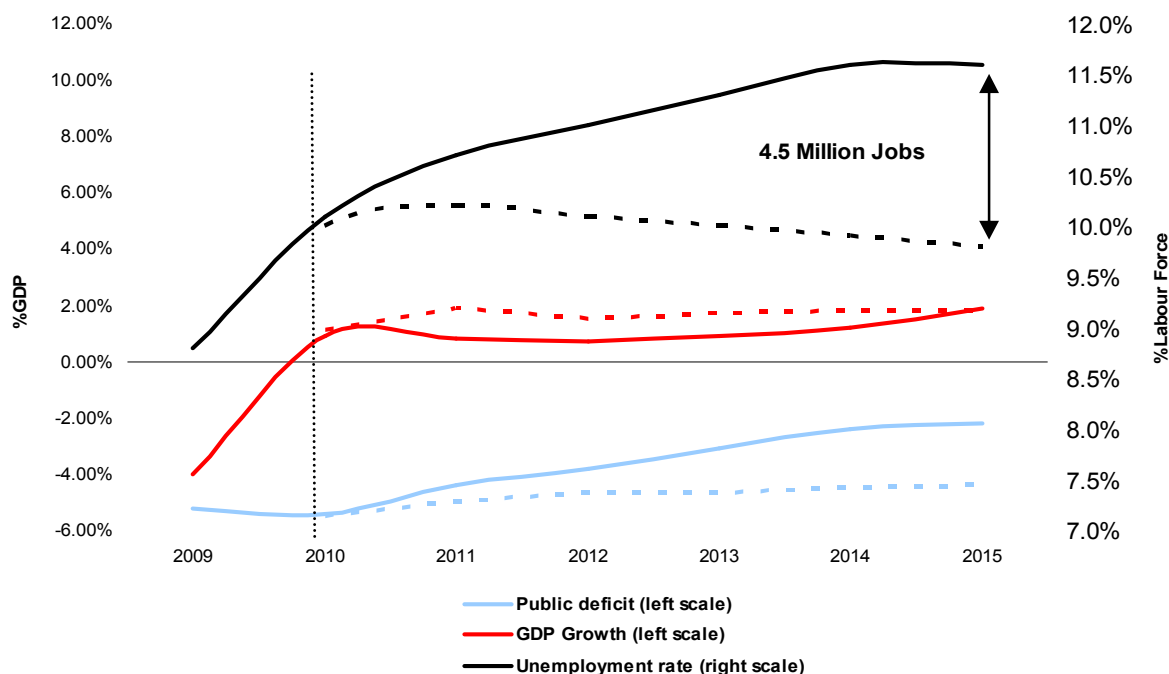
The European Conservatives' simple answer to this complex dilemma is fiscal consolidation. The March 2010 Council of Finance and Economic Ministers (ECOFIN) recommended fiscal stimulus measures going beyond 2010 to be withdrawn as soon as possible. The Council's conclusions call for the "exit strategy" to start as early as mid-2010. Their answer is simple: cuts, cuts, cuts.

Under the "Excessive Deficit Procedures", which now concern 25 out of 27 EU Member States, national budgets are expected to be tightened by an average of 1% of GDP per year until 2013, for an overall 3.5% fiscal contraction 2010-2014; this is more than the mirroring fiscal stimulus implemented between 2008 and 2010 – which accounts on overall for 2.9% GDP.

The 'cuts' logic has spread deeply in the current EU thinking, as reflected in recent policy initiatives undertaken by the European Commission. On 12<sup>th</sup> of May 2010 it proposed a long awaited reform of the EU economic policy governance. But the Commission's approach simply reproduces the same mistakes that presided over the creation of the SGP, by considering coordination merely as a tool for fiscal discipline. By completely neglecting the potential benefits of coordinating positive policies aimed at creating jobs and growth, Conservatives are now threatening Europe to enshrine their biased obsession with fiscal consolidation in the actual economic policy framework of the EU and its Member States.

The conservative majority in Europe has not understood the character of the crisis, its roots and consequences. It completely ignores the fact that virtually all Member States are still being hit by the recession. This makes it simply impossible to use cuts in public spending to get out of the crisis. If implemented, this unsound strategy would prolong the crisis and cause an even greater increase in unemployment, with a **price tag of extra 4.5 million jobs losses by 2013**, for only a marginal improvement in public finances (see graph 4).

**Graph 4 - What the Conservatives have in store: an 'Exit Strategy' that would march Europe's jobs out of the door**



The dashed lines represent the baseline scenario if the EU Council's recommendations are not implemented.  
Source: AE, OECD

The cuts already announced all across Europe will have devastating social consequences, in particular on the most disadvantaged group of the population, such as the elderly, children, youth,

women and migrants. Reducing child care, pensions, minimum wages, minimum income schemes, education expenses and health protection are the wrong way forward and will not help us to overcome the crisis. Fiscal tightening threatens the social progress achieved in Europe over the last 60 years. In reducing the provision of public services, the austerity approach will result in adverse effect on all segments of society.

### **(iii) Our Way – a balanced approach for sustainable growth, jobs and fiscal responsibility**

The PES' way out of this dilemma leaves no citizens or businesses behind. It is about continuous support for the real economy, coupled with a strategy for structural changes, fiscal consolidation and social recovery. It is aimed at both the short and the long run.

**The PES strategy consists of four immediate sets of actions that must be initiated simultaneously to engage our societies and economy on the right path toward recovery and a prosperous, inclusive and greener Europe. To resolve the dilemma, we must raise new revenues to avoid unnecessary cuts, put recovery at the heart of our policies and strengthen the EU's economic governance to invest in the future of our productive engine and social model.**

In order for both public authorities and private stakeholders in the EU to be able to secure recovery and pave the way for deep and lasting progressive changes in the structures of our economy, **the dysfunctions of the financial sector must be fully addressed**. In particular, the EU countries must be **insulated from the undue speculative market pressures** which distort policy-making.

Not least important is the necessity for the Member States to raise new fair revenues to achieve fiscal consolidation while not dismantling the welfare system, as well as to be able to conduct contracyclical and structural policies.

Economic recovery and long-term growth must be placed at the heart of public policies. For the reasons explained above, European governments cannot yet withdraw their support to the economy. Furthermore, as we are facing the challenge of changing the productive structures of Europe within the next decade, the macroeconomic cycle can be reoriented upward while also paving the way for sustainable green, smart growth. Public spending must be prioritised towards long-term investment.

Economic coordination in the EU, especially in the Euro-zone, must be strengthened. Its logic must evolve to include the use of positive spillover as well as to avoid negative ones. The transformation of the EU economic governance into a modern and robust framework, fit for the Europe 2020 strategy, must go hand in hand with the creation of a real economic government of the Euro-zone, fit for the single-currency.

## 2. Four policy actions for a progressive way out of the crisis

### **Action One: Against the Conservatives' plan to leave the door open for speculators, we must ensure that public policies are not dictated by the financial markets**

The prerequisite of our progressive strategy consists of providing governments and businesses with **breathing space**, necessary to conduct the policies that are required by the current economic context. EU Member States are pressurised by the markets into doing what is economically wrong in the current context: raising taxes on labour and businesses and cutting down public expenditures.

Governments have to work with the fear of being downgraded by the very rating agencies whose short-sightedness was instrumental at the onset of the crisis. If Member States are downgraded they become vulnerable to speculative attacks by bailed-out banks and unregulated hedge-funds. The example of Greece is representative of this: some cuts were necessary, but aggressive speculation dramatically exacerbated the need for tough austerity measures.

With no effective protection against speculative pressure, sovereign debt in many Member States will soon become impossible to finance, with or without expansionary policies. There is only one solution against these attacks: to **stand together in solidarity**.

#### *European Mechanism for Financial Stability*

The PES has been promoting the establishment of a “**European Mechanism for Financial Stability**”<sup>4</sup>, which acts as a mosquito net against speculators. This mechanism has been endorsed by the European Council – this is a good, although very late, first step. But more work needs to be done to fully protect our welfare states, and reverse the relationship between the financial sector and the real economy.

#### *European Monetary Fund*

Firstly, the EU must be granted with a fully-fledged crisis-management mechanism. A European Monetary Fund must be complementing the financial stability mechanism. It must be readily available to EU Member States, and benefiting from its protection cannot be synonymous to the destruction of welfare.

#### *Financial Regulation*<sup>5</sup>

Secondly, to achieve overall protection of Member States against speculators and to reverse the relationship between the real economy and the financial sector, concrete and ambitious proposals to complete the reform of the financial markets must be agreed. **The shadow finance casino must be shut down.** Hedge funds and private equity must be tightly controlled. All derivative products, including Over-The-Counter (OTC) must be regulated; some derivatives, such as Credit Default Swaps (CDS) on sovereign bonds, as well as harmful practices – such as naked short-selling – must be banned. An **independent European Credit Rating Agency** must be created, for both sovereign and corporate debt.

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<sup>4</sup> “A European Mechanism for Financial Stability: A Progressive response to the Euro-zone sovereign debt crisis”  
Adopted by the PES Prime Ministers’ and Leaders’ Conference on 25th March 2010

<sup>5</sup> See Annex I for a more detailed position.

## **Action Two: Against the Conservatives' plan to cut public spending and raise taxes on labour, we must yield new public revenue, through fair and sustainable instruments**

Fiscal consolidation must be achieved at medium term. If governments are, however, to continue spending to support the economy and to save our welfare states from massive cuts, the bulk of the consolidation will have to come from the revenue side. A number of instruments – both fiscal and non-fiscal – can be explored to ensure that an increase in the Member States' available resources is not achieved at the expense of those who have already suffered the most. Against the trend of an ever growing taxation of labour in European countries, the fiscal burden must be redirected towards other factors of production:

### *Fair green taxes*

New fiscal instruments must be developed to generate new and sizeable sources of revenue. Fair green taxes constitute part of the solution in the medium-term. These instruments must be directed particularly towards activities that impose costs on society but have not yet been adequately priced. The pollution of the environment and the emission of green house gases have not only negative impacts on nature, but also on the economy, health and social protection. Introducing taxes on the emission of CO<sub>2</sub>, and possibly other forms of pollution, would not only open up new revenue streams to be used for fiscal consolidation in the medium-term, but would also shift back the burden of paying for climate change mitigation and adaptation to the polluters who have caused the problem in the first place.

Through extending and tightening the Emission Trading System (ETS) and the introduction of direct taxation on greenhouse gas emissions, the price for releasing greenhouse gas into the atmosphere will increase and thus reflect the real costs that society bears. Revenues from the implementing of such measures are expected to yield billions of euro that could be used to finance climate change mitigation and adaptation, decrease the taxation on labour and help to spark the creation of sustainable, qualitative green jobs throughout the European Union. Furthermore, new green bonds could redirect funds from the financial markets into the “real” green technology economy. These green fiscal instruments must also be used as tools of social redistribution, to ensure that those with lowest incomes do not bear a disproportionate burden of the cost of any new taxes.

### *Financial Transaction Tax*

In the short-run, we must seize the momentum for a Financial Transaction Tax (FTT) and implement such an instrument at the European, and possibly global, level.

The PES has been calling for the introduction of a **0.05%** tax on all financial transactions, including OTC derivatives, in Europe first, then globally. It is a fair tax, which leaves ordinary people and businesses untouched. It is a powerful tool to change the business model of speculators and raise huge revenues.

**A European FTT of 0.05% would yield nearly €200 billion a year, leading to an increase by 1.3% in EU growth and creation of more than 2 million new jobs** (see table 1).

**Table 1 - The Financial Transaction Tax: 0.05% for an extra year of recovery plan and 2 million jobs**

Country	Revenu potential of the Tax in 2011	In % of recovery plan 2010	In % of recovery plan 2009	Job Creation Potential
EU27	€195.8bn	230%	140%	2,200,000
Eurozone	€148.1bn	200%	140%	1,300,000
Germany	€39.4bn	90%	110%	380,000
France	€32.4bn	1600%	160%	340,000
United Kingdom	€26.5bn	no stimulus	110%	180,000
Italy	€25.3bn	no stimulus	no stimulus	130,000
Poland	€5.7bn	110%	160%	130,000
Netherlands	€9.3bn	160%	180%	110,000
Czech Republic	€2.3bn	320%	160%	70,000
Spain	€16.9bn	270%	70%	60,000
Portugal	€2.7bn	1600%	180%	60,000
Belgium	€5.6bn	400%	400%	50,000
Sweden	€5.1bn	100%	110%	50,000
Austria	€4.6bn	90%	90%	30,000
Denmark	€3.7bn	200%	400%	30,000

*data source* : Eurostat.

*revenu potential* : own computation based on coefficient from S. Schulmeister; M. Schratzenstaller & O. Picek "A General Financial Transaction Tax. Motives, Revenues, Feasibility and Effects", Austrian Institute of Economic, march 2008. We use in this table the medium reduction in transaction volume scenario, for a FTT on all products, including OTC derivatives, set at 0.05%.

*Job creation potential* : own computation based on correlation coefficient between GDP growth at  $n$  and employment Growth at  $n+1$  based on historical series 1996-2008.

This revenue potential of the Financial Transaction Tax, although sizeable when compared to the size of the recovery plans implemented in Europe in 2009 and 2010, represents a mere fifth of the overall public deficit forecasted in the EU next year. This illustrates how much a new revenue stream is currently needed to support the Member States' budgets.

#### *EU structural funds, cohesion fund and European Investment Bank loans*

Non-national budget lines must be used to their full extent, such as the credit facilities granted by the European Investment Bank for specific investment projects, or EU structural funds and cohesion fund.

Regarding *EU structural funds and cohesion fund*, it is not enough to simplify the systems for advances and reimbursement, which is still to be ensured in practical terms. It is necessary to anticipate the multi-annual programming and to strengthen management structures. To increase financial capacity, corresponding to actual needs, we must go beyond the classical grant mechanisms. We ask for rapid implementation of schemes with interest rate subsidies for (i) energy efficiency and (ii) small and large urban development to address private and public investors at a municipal level. €8 billion euro fund money for these projects will create between €40 and €80 billion in investments for small companies with many jobs.

The *European Investment Bank* can add a guarantee instrument to the first anti-crisis package, which should be focused on major initiatives for climate protection, public transport and large

infrastructure projects in the new Member States, where neither the volume nor the long maturities of financing are provided by the market system due to significant market failures. A guarantee volume of €20 billion until the end of 2010 could mobilize €40 billion in investments, doubling the current effort. As these programmes are driven by loans and paid back out of resulting revenues, there will be no burden for the next generations. As the European Investment Bank has the power to borrow on international capital markets, this power should be used so that savings from the rest of the world and the countries with high saving quotas in Europe are used to invest to make the European economy sustainable and stronger. Central banks in Europe can be invited to back this initiative by buying these kinds of European Bonds, or “Eurobonds”.

### *Eurobonds*

Eurobonds (i.e. collective funding instruments in the form of debt securities issued by the European Commission) have a central role to play in the diversification of funding sources for national budgets, with respect to both the necessity to take pressure off national public debts as well as providing financial means to the achievement of European structural investment objectives.

Eurobonds can be used to promote a European solution to the increasingly difficult issue of how to handle rapidly growing sovereign debts in the Euro-zone. At medium term, we propose the establishment of a collective mechanism to pool a given ratio to GDP of national public debt in Eurobonds. Thus, all Euro-zone Member States would benefit from a predetermined level of collective borrowing at a fair, low market price, with the liberty to run higher individual public debt in the form of national bonds.

Eurobonds would reduce the cost of the long term investments for a greener and a smarter economy. The aim would be to reduce the spreads which are being paid by public debt to launch new investment projects, supporting business in general by decreasing the cost of capital, attracting domestic and foreign savings and preventing hostile takeovers by foreign investors. A European agency could be created to organize the common issuance of EU denominated bonds, with the guarantees to be provided by all participating Member States.

### **Action Three: Against the Conservatives’ obsession with immediate fiscal consolidation, we must make economic recovery and progressive structural changes our prime objectives**

With protection against speculation, and new tax revenues, EU governments will be able to conduct additional contracyclical policies as well as structural policies, provided that the rules applying to economic policies are adapted to the exceptional circumstance of the crisis and the objectives of transforming Europe’s productive structures.

### *Extending the deadlines*

The Conservatives’ “exit strategy” must not be implemented. The European Commission and Council must use the built-in flexibility of the Stability and Growth Pact to its full extent, and adapt the application of all ongoing Excessive Deficit Procedures (EDP). The EDP recommendations are absolutely unrealistic, and if implemented would result in a major backlash on employment and welfare states as a whole. Extended deadlines on the application of the SGP<sup>6</sup> will thus allow Member States to conduct policies needed to exit the crisis, and thus serve objectives of fiscal consolidation, too.

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<sup>6</sup> As provided by the Council Regulation 1056/2005 and the possibility for the Council to issue “revised recommendations”.

### *Prioritising public spending*

In prolonging expansionary fiscal policies, attention must be paid to the prioritisation of spending. Measures with higher long-term or permanent fiscal multipliers, such as public investment, must be favoured. The introductions of positive incentive mechanisms to that respect are needed. In particular, Member States which mobilise funding to achieve structural objectives of the Europe 2020 strategy should be granted with additional flexibility to do so.

The measures which have proven to be useful in the initial recovery package but are mostly efficient when implemented as a one off for a timely limited period of time, such as support of private consumption, should only be maintained as redistributive tools and for objectives of combating poverty. Otherwise, they should be gradually phased out.

Investments should be directed to labour intensive sectors to allow a fast reduction of unemployment with all its social and economic effects. Priorities for investments should be future technologies, such as green technologies, nano-technologies and the IT sector, or the increase of energy and raw material efficiency, contributing to increased competitiveness of Europe's economy.

It is however inevitable that some cuts will have to be made in the process of redirecting public spending. In doing so, governments must carefully assess all economic, social and gender equality implications of cuts. In particular, social transfer measures must only be affected by spending reduction under the fulfilment of the fair burden-sharing principle.

### *Progressive structural reforms*

The structural reform at the scale of the EU must be coordinated, through the implementation of a strong progressive Europe 2020 strategy. The PES has been advocating for the application of progressive structural policies, aimed at transforming Europe into a “**green, smart and inclusive**” economy.

Our long term objectives are:

- 1 – **to make a shift to low carbon activities**, in promoting new patterns of consumption, production and mobility, while ensuring a fair transition towards a carbon-free economy;
- 2 – **to turn knowledge and creativity into the main resources of people, companies and regions**, with competence-building for all and the active support of innovation, investment and job creation in new areas;
- 3 – **to renew and strengthen the welfare system**, to fight social inequality, in supporting change and protecting people, and providing high quality public services;
- 4 – **to redefine the role of macroeconomic policies**, to support job creation and economic growth.

### **Action Four: Against the Conservatives' standalone strategy, we must make the most spillover effect through the coordination of fiscal policies**

The economic governance of the EU must be strengthened, to allow not only for the protection of the single currency, but also for a greater efficiency of economic policy. The current framework – consisting only of the largely insufficient SGP – needs to be revamped. The SGP will require a further reform at medium-term, to transform it into a really effective instrument of sustainability. In the design of new normative rules, framing the conduct of fiscal policy in Europe, the focus needs to be shifted from public deficit to public debt, and enlarged to other key indicators, in particular employment, growth and current account imbalances within the European Union.

Fiscal policies in the EU, in particular within the Euro-zone, are made more efficient when adequately coordinated. Due to the fact that policies decided in large Member States have a tremendous impact in smaller Member States, and because, conversely, policies implemented autonomously in smaller Member States can be largely offset by opposed policies conducted in larger Member States, the coordination of fiscal policies in the EU is not an option, but a necessity.

The discretionary mechanism aimed at reaching a common European direction for fiscal policy must be largely redefined. In particular, the “Eurogroup” forum must be greatly strengthened, and given explicit objectives of growth and job creation.

Research conducted at the Danish Economic Council of the Labour Movement (AE) shows that coordination is not only relevant in the context of contracyclical policies, but is also a key factor of success for structural policy. For instance, if the largest economy of the EU – Germany – was to engage alone in our progressive Europe 2020 investment strategy, it would lead to a decrease of unemployment and stronger GDP growth. However, these results would be far inferior to what could be achieved if all EU Member States were implementing the same strategy together. The difference between coordination and standalone is, by 2020, 1.2 points of unemployment (6.2% against 7.2%) and 1.5 points of cumulated extra GDP growth (2% yearly average on the decade, against 1.8%). It even has an impact on fiscal consolidation, as in the case of coordination, Germany would reach by 2020 a deficit of -0.9%GDP, whereas without it would be -2.1%.

Coordination is also needed to overcome the macro-economic and social imbalances in Europe. Some imbalances were magnified by the crisis and are now more visible in the current accounts and the balance sheets of the households and companies. Their underlying causes might be explained by unsustainable public spending, wage developments or by lack of productivity improvements. Nevertheless, in the present conditions, they are also explained by lack of demand for investment and consumption at European level, inequalities in income distribution, increasing unemployment and poverty, deeper regional inequalities and lack of effective instruments to finance public budgets. Therefore, multilateral surveillance should follow-up these different dimensions in order to identify the appropriate and specific solutions. Beyond the national specific solutions, there are general principles which should be implemented. Macro-economic and social imbalances can be reduced by better conditions for recovery in all Member States. This requires stronger economic coordination.

With respect to the “Europe 2020” process, the EU needs to develop a new model of economic governance in order to ensure that policies are made more efficient, with stronger instruments and multilevel actions combining the local, national, European and global levels.

The political accountability of the European institutions and governments regarding the implementation of coordinated policies must also be strengthened. The participation of all the relevant stakeholders and the exploitation of the full potential of the Lisbon Treaty, with respect to policy coordination, must also be ensured.

### 3. A progressive plan for Europe's future

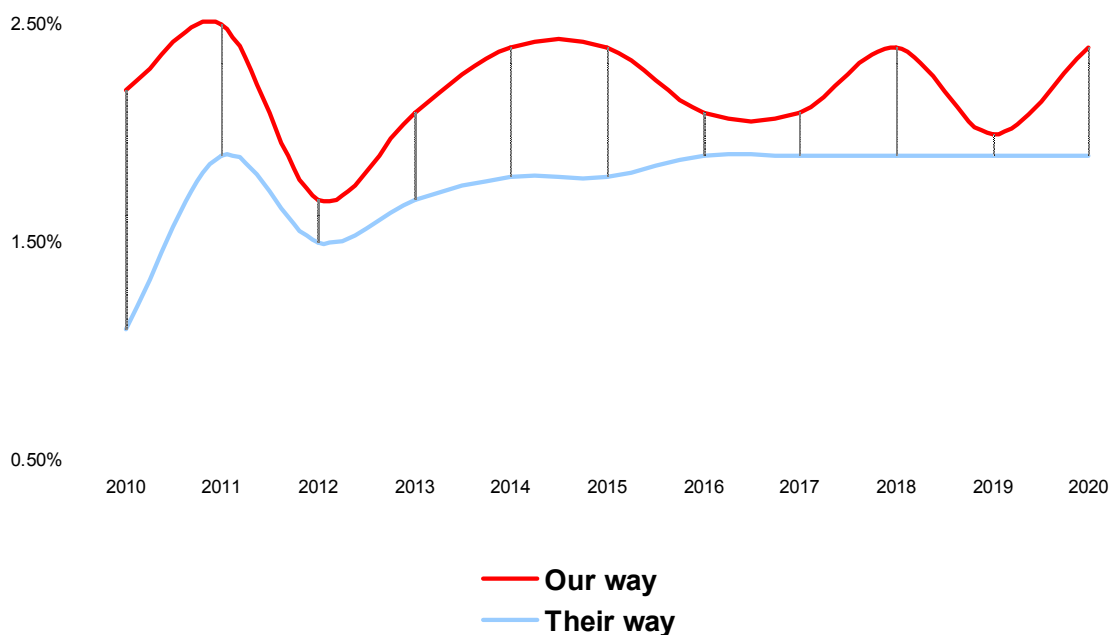
Equipped with the afore mentioned instruments and executing the four progressive actions, we will be able to engage toward the full reorganisation of the very structures of the European economy.

If implemented, the structural changes we promote would translate into higher and more sustainable growth, increased employment and even faster fiscal consolidation than compared with the continuation of the current conservative policies.

**Within the next 5 years, the PES strategy for a progressive way out of the crisis would create 6 million jobs; the Conservatives' "exit strategy" would destroy 6 million jobs. By the end of the decade, our strategy will create 14.5 million jobs, lead to a decrease of the unemployment rate to 6.8% and drive our public deficits back to the Maastricht Treaty limit.**

Through the whole decade, GDP growth would be significantly higher with the implementation of progressive structural policies. Except for 2012, growth rate would be superior to 2% per year. The continuation of current policies, however, would only result in sluggish growth (see Graph 5).

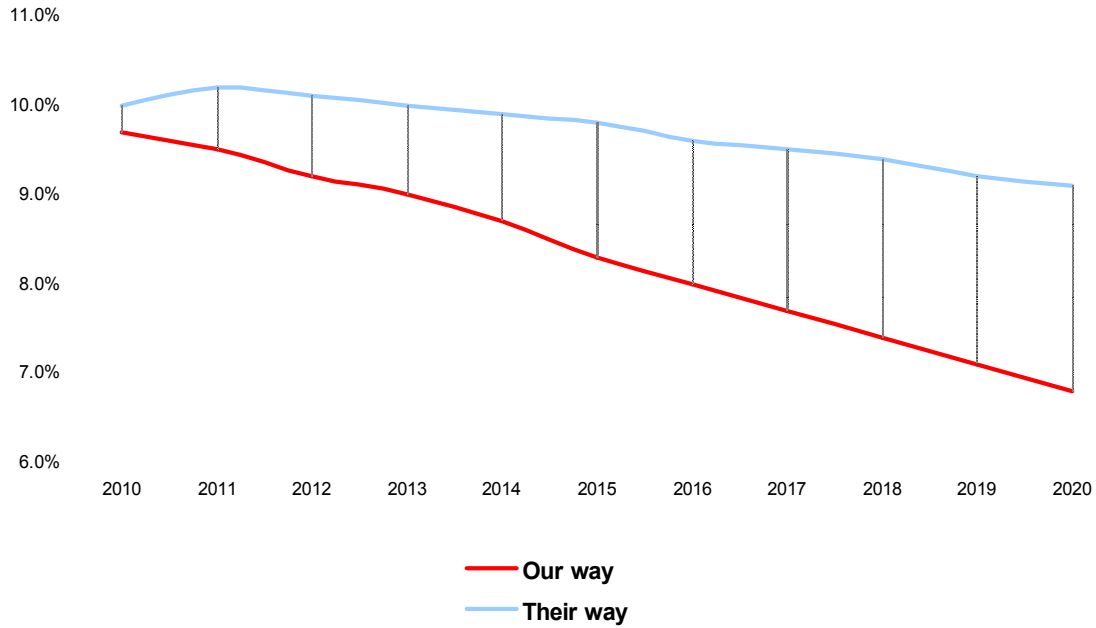
**Graph 5 - GDP Growth Rate**



Source: AE

While the continuation of the conservative policies would only lead to a sustained, high level of unemployment above 9%, our way would result in a dramatic decrease of unemployment, below 9% as of 2014, and below 7% by the end of the decade (see Graph 6).

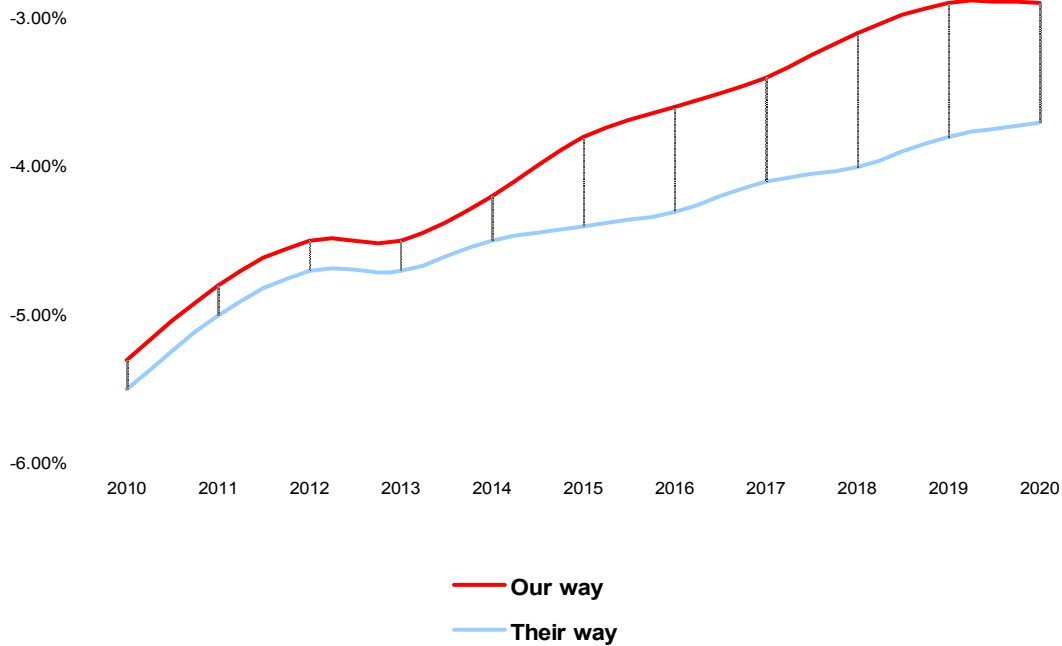
**Graph 6 - Unemployment Rate**



Source: AE

Even in terms of fiscal consolidation, our solutions are better fitted than the continuation of current policy. In lowering unemployment and generating growth, our strategy would gradually bring Europe back to sustainable public finances, at a pace compatible with a long lasting economic recovery (see Graph 7).

**Graph 7 - Public Deficit**



Source: AE

## The Choice

The Conservative's strategy of going back to "business as usual" and trying to undermine our welfare states is now framing the public debate on the post-crisis policy environment – and already threatens the EU's economic and social future. European Conservatives are the only ones in the world insisting on this aggressive "exit strategy". This would only result in marching Europe's jobs out of the door and killing any signs of positive growth. Europe needs fiscal responsibility and structural reforms, but also regulation of financial markets and recovery measures for growth.

**A clear choice has to be made.** The choice is between austerity or recovery, between rushed fiscal consolidation or safeguarding jobs and sustainable growth, between "exit strategy" of public involvement or "entry strategy" into the labour market. The choice is between more of the same, or an ambitious structural reform strategy. It is between continuing to reinforce social inequality or reversing the trend.

The Progressive European family, led by the PES, must fight for its voice to be heard. Together, we must ensure that Europe and its citizens will emerge stronger from the crisis. Against the destructive stance of Conservative forces, the PES commits to stand united for a progressive way into a prosperous, inclusive and sustainable European future.

## Progressive Regulation of Financial Markets

In the aftermath of the first shocks that hit the global financial system in 2007, international momentum for radical reform of the financial system peaked at the 2009 G20 summits in Pittsburgh and London. The Party of European Socialists (PES) hoped for a critical re-thinking of three decades of financial neo-liberalisation. But now, nearly three years after the subprime crisis, European Conservative Governments continue with their irresponsible political programme:

The Conservatives' only ambition in addressing the crisis and its consequences is to brush coat after coat of fresh paint over the cracks revealed in the walls of their economic house. Their focus on the "quick buck" is by definition short-sighted; the right simply does not have the tools to overcome this crisis, to draw the necessary conclusion and to launch an alternative for Europe.

**The Party of European Socialists refuses the draconian policies prepared by conservative forces and urges European institutions to renew their effort for long overdue financial reform:**

### 1. Promoting fair burden sharing for the current and future cost of financial crises:

In the future, taxpayers should not be the main source of 'rescue funding' of the financial and banking sector:

- The time has come to introduce [a Tax on financial transactions](#) to ensure a fair contribution from the financial sector to the real economy:

1) Taxing financial transactions will have a stabilizing impact on financial markets by curbing short-term and "socially useless" trading due to high speculative activities

2) An FTT of 0.05% will yield a future and permanent contribution of about 1% of world GDP per year. In Europe alone, it will bring around €200bn a year, i.e. more than the current budget of the European Union.

- We support the creation of a **European bank guarantee fund** to protect depositors across the EU and a **stability fund** financed by financial institutions supervised at EU level to ensure that they will have to pay the cost of future crises they may cause.

### 2. Ensuring an all encompassing control on financial products and practices:

- **Derivatives constitutes one of the most opaque part of the financial system:**

So far, G20 policymakers have agreed on the need to relocate as many Over The Counter derivatives that are deemed eligible for clearing through clearing houses (Central Clearing Parties) after they have been traded. **Therefore, these "financial weapons of mass destruction" should be subject to proper registration, central clearing and tight European Supervision.**

Central Clearing Parties should play a more intensive role in the regulation of financial markets by improving the stability and security of the financial system: they should now guarantee that a trade goes ahead even if one party defaults. Credit Default Swaps on sovereign debt are purely socially useless products and should be therefore banned.

- **Improper and high risk activities must be either banned or strictly regulated:**

Regulatory market authorities should be entitled to restrict short-selling when necessary. The Market Abuse directive must be reviewed to ban high risky speculative practices such as naked short selling and empty voting.

- We urge the European Commission to lead the **necessary investigations on the activities of private credit rating agencies and assess the opportunity to propose additional rules** concerning their rating methodology and transparency requirements. We also support the creation of a **European independent rating agency** that will bring more objectivity and diversity in the rating market.
- Inconsiderate compensation schemes of financial institutions have been one of the main causes of the current economic and financial crisis by encouraging excessive, short-sighted and risk-taking activities. The magnitude of the turmoil clearly exposed the ineffectiveness of non-binding recommendations and other codes of good practices in terms of remuneration policies. Therefore, **independent committees** of financial institutions or listed companies should include all stakeholders and define binding remuneration policies based on sustainable and risk-sensitive principles. Amounts of variable remuneration should be linked to long-term objectives and effective performance of the overall company.

### **3. Strengthening the European supervisory and regulatory framework of financial institutions to avoid new crises:**

The massive economic and financial crisis exposed the major weaknesses of so-called soft regulation and the lack of robustness and consistency of the fragmented regulatory and supervisory framework on financial actors.

To this respect, we support a more integrated approach in the field of financial supervision.

- **Hedge funds and private equity must now be subject to effective regulation in terms of leverage and asset stripping, and fulfill transparency requirements.** Furthermore, EU legislation should apply in a similar manner to EU as non- EU funds/ funds managers.
- **European Systemic Risk Board should also be considered as a major watchdog** assessing and declaring the imminence of a systemic risk and preventing contagious effects. ESRB should be chaired by the ECB president and its board membership should include academic experts.
- We also urge head of states to confer, as proposed by the European Parliament, **direct supervisory competence to European Supervisory Agencies** on financial institutions and give them binding powers to settle disagreements among national supervisors.
- It is high time to restore traditional narrow banking and ensure a complete separation between “casino” banking and activities such as deposit-taking and the provision of loans.
- The crisis has demonstrated significant deficiencies in current EU banking regulation. As agreed by G20 leaders in 2009, the European Union has to build and increase higher quality capital requirements, strengthen liquidity risk requirements, mitigate pro-cyclicality, discourage ill-considered leverage and strengthen forward-looking provisioning for credit losses. Agreements reached under the aegis of the Basel Committee on banking Supervision should come into force in the form of international treaties.
- **Tax havens, offshore financial centers and bank secrecy jurisdictions must belong to the past** and effective sanctions should be applicable to non-compliant territories.

**We will not let the European financial sector slip back into bad old habits. We will form new habits based on a fundamental belief in transparency, accountability and the public good.**