



Building a More Prosperous Europe

Progressive, Pragmatic, and Pro-Growth Policies Will Help Boost Jobs Growth and Stem the Sovereign Debt Crisis

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Introduction

The victory of Francois Hollande in the second and final round of the French presidential elections this past weekend will hopefully mark the turning point in both the economic fortunes of the European continent and the political fortunes of Europe's progressive political parties. Hollande, the leader of the Socialist Party, boasts the qualifications to lead a pragmatic, progressive, pro-growth economic revival in Europe.

In the short term this revival will require both labor market reforms, public- and private-sector investments aimed at stimulating job growth, and financial innovations to help attract new financial capital into the real economy. This revival must also be focused on balancing medium-term fiscal responsibility with a long-term vision for modern industrial renewal.

This issue brief explores the new French president's pragmatist leanings to achieve these goals, then examines the current austerity measures that voters across much of Europe are rejecting—Hollande's victory being the most overt symbol of rejection to date. This analysis closes with a look at why the conservative austerity approach isn't working and then details the kinds of policies Hollande and other progressives in Europe are likely to champion to restore European economic growth and prosperity.

President Hollande is a pragmatist, not an ideologue

Those concerned that the new French president's political leanings will put market stability at risk are mistaken. Francois Hollande is no ideologue. On the contrary the new president is a pragmatic progressive who realizes that austerity hasn't worked. He recognizes what Europe needs is a realistic strategy for job creation and economic growth. A pragmatic, progressive, pro-growth agenda is what he will deliver, which is precisely what Europe needs.

Much of Europe is now falling back into recession, with unemployment across the continent continuing to grow and the eurozone sovereign debt crisis once again spiraling out of control. Hollande realizes that the policy options open to any one nation in a highly integrated European economic area are marginal. This is why Hollande will focus immediately and comprehensively on Europe.

During the presidential campaign Hollande advocated in favor of a financial transaction tax in the eurozone to fund industrial restructuring. He suggested he might renegotiate the EU fiscal pact agreed to in December—a pact many believe imposes overly tough fiscal constraints and European supervision on member states’ budgets. He also proposed the creation of eurobonds issued by the European central bank to mutualize sovereign debt burdens. At the time these policy positions placed Hollande at the center of a pan-European progressive movement that sought to compete with conservative visions for the continent’s future, which were centered on fiscal austerity alone as the answer to Europe’s economic and budgetary ills.

Evidence suggests that a rejection of austerity policies will be the hallmark of the Hollande presidency. Speaking at the Bastille in front of his supporters on Sunday evening, Hollande stated that his victory was a “message for all the people of Europe who, regardless of their leaders, want an end to austerity.”¹

Conservatives have questioned the true nature of Francois Hollande’s politics. But in October last year, during the Socialist Party’s primary, Hollande clearly positioned himself as a pragmatist. His main opponent within the Socialist Party, Martine Aubry, argued that the French wanted a more ideological left to combat the populism of the right. Hollande countered this, arguing that the French had become tired and wary of ideology. What they really wanted, he said, was a steady, pragmatic hand at the tiller. The 2.5 million citizens who voted in the second round of the primaries agreed with him, delivering him the Socialist Party nomination.

As the presidential campaign heated up, however, the communist-backed, hard-left leader Jean-Luc Melenchon began to draw massive crowds at rallies, leading Hollande to voice more left-leaning campaign themes. Shortly before the first round of the presidential vote earlier this year, Melenchon rose to third place behind Hollande and Sarkozy, polling at more than 15 percent of the popular vote. But the far-left leader fell back in the closing days, and only received 11.1 percent of the first-round votes.

For some commentators, then, Hollande’s shift in tone is best understood as a simple campaign strategy. When competition from the left emerged, Hollande had no choice but to close off this political flank by pledging to impose a 75 percent tax rate on those earning more than 1 million euros (about \$1.3 million). Beyond this, however, it’s fair to say that one of the dominant themes of the contest was fairness, combined with an attack on the undeserving rich.

In April the French political weekly *Le Point* ran a front cover that superimposed the faces of French opposition politicians onto Jean-Victor Schnetz's celebrated "Fighting at the Hotel de Ville," a painting of a street battle during the July 1830 revolution that toppled the restored Bourbon monarchy.² More recently, French pollsters CSA presented 1,000 voters with 19 keywords picked from the 2007 and 2012 campaign slogans and asked which best represented the state of French society and which best described their personal state of mind. The two most-used words to describe society were "profit" (53 percent) and "capitalist" (43 percent), while the two that respondents most used to describe themselves were "change" (28 percent) and "solidarity" (25 percent). Only 4 percent picked "justice" as a good description of the state of France while 22 percent said it was a personal aspiration.³

In tandem with the growing evidence of the failings of austerity and the current European path, a strong egalitarian critique of the economy emerged in France. Indeed, a growing body of international evidence suggests that rising inequality levels are bad for growth, and that focus should be placed on the middle class. By putting these themes at the center of his campaign, Hollande sought both to occupy the center ground of the French political spectrum and focus his vision on a new evidence base. This leads to an approach appearing to be as values driven and pragmatic as it is ideological reversal or campaign strategy.

Whatever the reason, and whatever rhetoric Hollande may have used to guard his left flank during the presidential campaign, the president-elect's economic advisors pivoted back to pragmatism and began to sketch out a realistic European agenda during the final days of the campaign. On the eve of the first round, Elisabeth Guigou, former finance minister and advisor to Hollande, addressed a meeting of the progressive parliamentarians network organized by the Center for American Progress in Rome. There she suggested that rather than pursuing a burdensome renegotiation of the EU fiscal pact and European central bank eurobonds for mutualizing debt, Hollande would actually seek to complement the pact with a jobs-and-growth agenda at the European level and push for the creation of European "project bonds" designed to leverage private capital into much-needed European infrastructure and industrial investment projects.⁴ Hollande himself also promised to pursue a prudent fiscal policy and to balance the national budget by the end of his five-year term.

The rise of austerity politics

Hollande's policy platform is to a great extent a reaction to the conservative austerity agenda that has dominated the European debate since the onset of the financial crisis. In the immediate aftermath of this crisis, progressives across Europe suffered a string of electoral defeats. In "The European Paradox,"⁵ John Halpin, Ruy Teixeira, and I sought to analyze why the fortunes of European progressive parties had declined following the previous autumn's sudden financial collapse and the global economic recession that ensued. Our starting point was that progressives should, in principle, have had two strengths going for them:

- Modern trends that were shifting the demographic terrain in their favor⁶
- The intellectual and policy bankruptcy of conservatism, which had now proven itself devoid of creative ideas of how to shape the global economic system for the common good

Despite these latent advantages, we surmised that progressives in Europe were struggling for three primary reasons. First, it was increasingly hard to differentiate themselves from conservative opponents who seemed to be wholeheartedly adopting social democratic policies and language in response to the economic crisis. Second, the nominally progressive majority within their electorate was being split between competing progressive movements. Third, progressives' traditional working-class base was increasingly being seduced by a politics of identity rather than economic arguments.

Whatever the cause of the decline of Europe's progressives, it facilitated the rise of austerity politics across Europe. The immediate reaction to the global crisis—led by then-British Prime Minister Gordon Brown and President Barack Obama at the London and Pittsburgh meetings of the Group of 20 leading developed and developing nations in 2009 and 2010—was focused on coordinated stimulus and job protection and creation measures. But this consensus quickly dissolved once President Obama's progressive congressional support was replaced by an increasingly conservative Republican Party, which took control of the House following the 2010 midterm elections.

The debate in Europe (and to some extent in the United States) was then swiftly transformed by conservatives and later in the eyes of the public into a crisis of excessive public deficits and the profligate state. While initially the center-right in Europe sought to adopt social democratic language and policies in response to the financial crisis, once they had successfully reframed the nature of the crisis they quickly reverted to type and began calling for a retrenchment of the state.

The domestic answer to the economic woes was to cut spending dramatically. Greece, Portugal, and Ireland—and more recently Italy and Spain—were all compelled to impose ever harsher austerity measures on their economies due to the December 2011 EU fiscal pact—driven by Christian Democratic Chancellor of Germany Angela Merkel and the conservative French President Nicolas Sarkozy—despite having already made their own substantive steps toward fiscal reform. The fiscal pact not only called for further economic, social, and fiscal reforms but also stipulated greater European-level scrutiny over domestic budgets and constitutional reforms to limit public deficits in return for bailouts from European partners.

Austerity isn't working

In recent weeks, however, there is growing evidence that austerity is an economic failure. Politically and socially, too, austerity is damaging to the European Union's global image and influence on a world stage.

In late April the economy of the United Kingdom—under the leadership of Conservative Party Prime Minister David Cameron, who had been one of the strongest advocates of austerity—re-entered recession. Growth in Spain continues to stagnate, with unemployment levels reaching a record high of 25 percent—and 50 percent for youth unemployment. Across the entirety of Europe the unemployment rate is now almost 11 percent, with a further 169,000 job losses recorded in March. This time last year the rate was 9.9 percent. This is the highest level since the euro was launched just more than a decade ago.⁷

Beyond the unemployment numbers, austerity politics are aggravating the sovereign debt crisis, exposing macroeconomic imbalances, and heightening intra-European tensions. As other regions of the world begin to recover or continue to grow, Europe is in danger of falling behind its global competitors and suffering a “lost decade” of stagnation and economic decline. In 2012 the European economy is expected to shrink by 0.5 percent. In contrast, the United States will grow by at least 1.8 percent (with employment slowly declining most recently to 8.1 percent), a vindication of the growth-and-investment strategy pursued by President Obama.

As a recent paper issued by the German Social Democratic Party, currently Germany's official opposition, argued:

Economic strength is essential for consolidating government finances. The escalation of the eurozone crisis poses the greatest threat to Europe's prosperity today. Since the fall of the investment bank Lehman Brothers in 2008, the collapse of deregulated financial markets and their highly speculative products, and the subsequent sharp downturn in the real economy, more and more countries in the eurozone have been falling into the vicious circle of debt, refinancing crises, recessions, and ever-higher debt quotas.⁸

In short, it's not just that austerity isn't working; it's actually making public finances worse.

Undoubtedly, there is an urgent need to trim government budget deficits, but there is now a growing consensus that restrictive fiscal policy alone will not suffice. Indeed, even the credit rating agency Standard and Poor's now considers the lack of growth to be a bigger problem than budget deficits when it comes to the sustainability of sovereign debt. This is because the anticrisis strategy of issuing emergency loans and making budget cuts has increased risks for creditors rather than reduced them. The first bailout package for Greece in spring 2010 cost €110 billion. Two years later, aid programs for

Greece, Ireland, and Portugal total €403 billion. Two years ago Germany had to guarantee €22.5 billion in emergency loans. Today it is backing a sum of €211 billion.

As if this growing exposure is not enough, at present there is little indication that there will be a change to the current recessionary spiral. Yet if growth doesn't come, loans will not be repaid. The EU and International Monetary Fund rescue packages assume that the countries receiving emergency loans today will soon be able to generate "primary budget" surpluses, meaning the budgets are in balance except for interest payments on the sovereign debt. Unfortunately, this is unlikely to happen anytime soon. As such, debtor nations will still require new loans, thus putting the eurozone through further political and economic tests in the near future—tests it looks ill equipped to pass at present.

In this context it is perhaps not surprising that the number of "political" victims of austerity continues to rise. Nicolas Sarkozy is just the latest in trend that includes (in the last month alone) the conservative center-right government in the Netherlands, which fell following a failure to pass its budget, the Greek technical or expert government established last year to push through fiscal reforms, and the recently installed Romanian government. In southern Europe, Prime Ministers Mario Monti in Italy and Manuel Rajoy in Spain are both reaching the limits of their mandate, with growing political and civil opposition to further reforms.

That said, the ascent of Francois Hollande to the Élysée Palace looks set to transform the political landscape. The outgoing President Sarkozy was a key leader of the successful campaign to impose the EU fiscal pact on EU members. He has been replaced by a leader that actively campaigned for renegotiating that pact. So what can we expect from a Francois Hollande presidency? And, perhaps more importantly, what levers are at his disposal to transform the European agenda?

A new European strategy

According to Michel Sapir, one of Hollande's key financial and economic advisors and a former finance minister in a previous Socialist government, the president-elect's proposed growth plan will be comprised of four elements:

- The creation of commonly issued eurobonds to finance infrastructure, industrial investment and employment
- Additional financing of investment by the European Investment Bank
- The imposition of a financial transaction tax by those EU member states willing to use it to fund development projects
- The more efficient use of EU structural or regional development funds⁹

The approach reflects a growing consensus among European progressives that industrial renewal must rest on two pillars: structural reforms and growth-oriented fiscal policy.

To achieve this, Europeans are hoping to pool the investment potential of the public and private sectors, as well as European level and national funds, and focus these on innovative growth areas such as mobility (automotive industry, rail technology, aviation, and logistics), infrastructure, energy renewal and resource efficiency, and health care.

Three objectives would guide this approach. Specifically:

- Rationalizing current government spending and raising new income
- Strengthening the European Investment Bank
- Attracting private capital to public-private investment opportunities

Let's look at each of these objectives in turn.

Rationalizing current government spending and raising new income

In contrast to conventional economic stimulus programs, progressives are now arguing that future investments should not be financed with new debt but should rather come from pooling existing resources such as the European Union's Structural Funds—European-level investment funds designed to improve the competitiveness of regional economies and specific sectors in Europe—and through new revenue generated by a financial transaction tax.

The funding to be disbursed from the Structural Funds between now and the end of 2013 amounts to €232 billion for the European Union as a whole. More than €13 billion of that total is allotted to Greece and more than €4 billion of the total has not yet been earmarked for specific projects and is therefore still available. A European-wide financial transaction tax as proposed by the European Commission could generate a further €55 billion each year.¹⁰

Looking ahead to 2014 and beyond, progressives argue the goal should be to combine resources from the financial transaction tax with resources from the European Structural Funds under the new multi-annual financial framework to provide greater market certainty for private investment into these projects.

Strengthening the European Investment Bank

There is now a growing consensus that the European Investment Bank needs to take on a key role. To do so, its status within the European institutional hierarchy will need to be upgraded. Increasing its financial strength would improve the bank's equity and its ability to invest and drive reform. By strengthening the investment funds available to the bank by a further €200 billion, the European Investment Bank would be better able to help incentivize private investment in key pan-European infrastructure projects, and thus re-enforce the more strategic use of existing Structural Funds.

Attracting private capital to public-private investment opportunities

There is a growing consensus that Europe needs to revive and expand its capital markets to finance infrastructure projects. According to EU Commission estimates, 1.6 trillion euros is needed for the transport and energy sectors alone over the next 10 years.¹¹ Unfortunately the new regulatory framework for banks and insurance companies adopted in the wake of the global financial crisis weakens their appetite for long-term investment.

This is why European “project bonds” can be used to trigger far more private investment. They would be backed by the European Investment Bank, lowering the risk rating associated with these financings and thus allowing for institutional investment. Moreover, should these bonds be accorded a status of their own—in between corporate and government bonds—it would also be possible to lowering co-financing requirements, which would ensure faster take up.¹²

Toward the Europe we need

Despite recent electoral victories for progressives, including Hollande’s, in France this past weekend, the capacity of these parties to fundamentally reform Europe’s economic architecture is still relatively low. The majority of the European Union’s member states are still governed by conservative or center-right coalitions.

Yet even among the conservative and technocratic ranks, there is a growing disquiet with the current austerity approach. Taken individually, then, each of these progressive initiatives outlined by Hollande and his advisors might appear as a piecemeal endeavor, but combined they provide the skeleton of a new progressive economic agenda—one that a significant number of conservative-led governments (including Merkel’s Germany) might be willing to coalesce around.

Moreover, the tensions around the eurozone are only likely to grow in the months to come. Over the next 24 months both Greece and Ireland will hold the rotating presidency of the European Union. One imagines that they will use their presidential pulpit to push for further policies that put growth back on the agenda. With elections in Italy due in the spring of 2013, and Germany the following fall, the stars are beginning to align for a more progressive approach.

Hollande’s revised agenda is but a step in the right direction. It is designed to place growth back at the heart of the European economic challenge. With time, however, it may be just a stepping stone on the road to more substantial reforms.

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Endnotes

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- 4 Elisabeth Guigou, "Re-Write the World Conference," Speech at the Progressive Parliamentary Network meeting co-hosted by Center for American Progress and the Italian Democratic Party, Rome, Italy, April 18, 2012.
- 5 Matt Browne, John Halpin, and Ruy Teixeira, "The European Paradox" (Washington: Center for American Progress Action Fund, 2009).
- 6 For example, the rise of a progressive younger generation, the increase in immigrant and minority populations, and the continuing growth of the professional class.
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