A new economics for the EU*

EU leaders should consider an economic strategy that favours not austerity but growth and employment

While David Cameron attends the quarterly summit meeting of EU leaders in Brussels this afternoon and tomorrow, discussions will be split between two seemingly rival agendas. One – promoted by Britain – seeks to limit the increase of the union's budget at a time of national spending cuts. The other – pushed by Germany and France – envisages a treaty change to impose tougher sanctions on over-spending members of the eurozone, in a bid to prevent another Greek-style sovereign debt crisis.

In reality, both agendas are part of a wider drive to stamp out fiscal profligacy and entrench austerity. This pan-European strategy undermines the fledgling recovery amid fears of a looming global currency and trade war. Greece remains trapped in a spiral of debt-deflation, as the austerity-induced recession is raising the real value of the country's debt – 127% of national output in 2009, up from the earlier projection of 115%. Under the burden of an unprecedented banking bailout, Ireland's economy is fast contracting. As Simon Jenkins has argued, the UK public and private sectors are de-leveraging and hoarding cash in anticipation of a slowdown – a self-fulfilling prophecy presaging a double-dip recession. Germany, France and the rest of the eurozone's core are growing, but buoyant German exports are fuelling the imbalances between the EU's surplus and deficit countries.

This, coupled with a lack of bank lending to businesses and households, has led to a situation where banking conglomerates are using public money – thanks to taxpayer-funded bail-outs and central bank quantitative easing – for pay increases and speculative profits. This is enriching institutional shareholders and the top management while starving the real economy of funds for consumption and investment. At a time when both investors and consumers are losing confidence in the recovery, swingeing cuts in public spending across Europe and higher consumer taxes (such as the UK coalition's proposed VAT hike in January 2011) are putting a ceiling on economic growth.

The deal on the table at the EU summit is another foul compromise: Britain won't block treaty changes proposed by France and Germany in exchange for a smaller increase in the EU budget than the 5.9% voted for by the European parliament. On one level, Cameron's pragmatic Euro-realism is a welcome contrast to the hardened Euro-scepticism of his backbench, Thatcherite MPs who clamour for a larger UK rebate and a repatriation of powers from Brussels to London.

But the real debate is different. Instead of focusing on austerity, what the EU needs is an investment strategy that fosters growth and employment. First, EU leaders should modify the composition of the €140bn union budget, away from wasteful expenditure towards productive activities. The common agriculture policy – accounting for over 40% of total resources – should not subsidise agricultural prices, which fuels excess production and hurts developing countries. Rather, it should support investment in smallholding farms and farming cooperatives. Other examples include the channelling of regional and structural funds as well as education and R&D expenditure into projects with revenue streams in excess of funding costs.

Second, the 27 member-states could expand the remit and funds of the European Investment Bank by underwriting increased lending. This could be used for infrastructure and other investment projects that yield a higher monetary return than the borrowing costs. Concrete examples include housing associations and investment trusts at the local level but also high-speed rail, broadband internet and alternative energy at the trans-regional level, within and across national boundaries. Many European regions trade more which each other than with their domestic hinterland.

Third, the EU as a whole must also tackle private sector imbalances, starting with tough penalties for banks that use public money for bonuses and boardroom pay rises instead of lending to cash-strapped small- and medium businesses and households. The union should also consider a financial transaction tax. Even the IMF – normally the guardian of neoliberal orthodoxy – has shown in a recent paper entitled «Taxing Financial Transactions: Issues and Evidence» that a tax of no more than 0.01% on currency exchange and the trading of stocks, bonds and derivatives could generate substantial funds while knocking off a minuscule percentage of the value of stock-markets in the process.

As the world's single biggest economic space, the EU could pioneer a new economic and financial settlement. Relying on the Obama administration or the G20 is like waiting for Godot.

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