Crisis of Distribution, not a Fiscal Crisis
by Özlem Onaran

We are in a new episode of the global crisis: the struggle to distribute the costs. This crisis has been one of the outcomes of increased inequality at the expense of labour post-1980s. Lower wage share created demand deficiency; this coupled with financial deregulation reduced investments despite increasing profitability. Financial innovations and debt-led consumption seemed to offer a short-term solution, which has collapsed since 2007. The crisis was tamed via major banking rescue packages and fiscal stimuli. Now the speculators and business lobbies are relabelling it as a “sovereign debt crisis” and putting pressure on governments in a variety of countries ranging from Greece to Britain to cut spending to avoid taxes on their profits and wealth.

In Europe, the crisis laid bare the historical divergences. At the root of the problem is the neoliberal model which turned the periphery of Europe into markets for the core. The restrained policy framework - which is based on strict inflation targeting, and which lacks fiscal transfers targeting productive investments in the periphery - is the root of the divergences. The Stability and Growth Pact, as well as EU competition regulations, limited the implementation of national industrial policy. In the absence of investments to boost productivity and unable to devalue, the only option open to countries like Greece, Portugal, Ireland and Spain in the periphery of Europe was to lower wages. But this did not save them either, since Germany was engaged in a much more aggressive labour market policy. Between 2000 and 2007, unit labour costs declined by 0.2% a year in Germany while they increased by 2% in France; 2.3% in Britain; and between 3.2% and 3.7% in Italy, Spain, Ireland and Greece. In the periphery, labour costs have increased faster than in Germany due to higher inflation. However, there was still wage moderation in these countries: in the 1990s and 2000s, productivity increases exceeded changes in real wages in all western EU countries, with the gap being largest in Germany. Overall labour’s share in income declined sharply in Europe. In Germany, Italy, Spain and Portugal, real wages even declined in the 2000s. The phenomenal advantage of Germany was due to wage suppression rather than increasing productivity.

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

This is the background of the sovereign debt crisis unleashed in Greece. Indeed, before Greece, in 2008-09 Hungary, the Baltic States and Romania were under attack. Now, together with Greece, the attention of the speculators has turned to the public debt and deficits in Portugal, Spain, Ireland and then towards the core: Italy, Britain, Belgium and even the US. The EU’s joint rescue packages with the IMF came after months of destructive dithering and speculations about Greece’s default and exit from the Euro. The European Central Bank (ECB), which acted as a lender of last resort to private banks, did not fulfill the same function in the case of the Eurozone governments until May 2010 when, ironically, the banks it saved speculated fiercely about default. The Eurozone governments are indeed protecting their own banks that are holding Greek bonds, the bulk of which are held by German and French banks.

Greece is now pushed to follow Ireland and Latvia as role models in dramatic cuts in public sector wages, pensions, spending and increases in taxes. Portugal and Spain have also subscribed to an austerity recipe. Britain’s new coalition government declared its commitment to severe cuts.

The speculators now worry that these measures are not a solution to the problems: first they think the default of Greece is inevitable given the popular resistance and the size of the debt. Second, in a schizoid way, they are worried that austerity measures will deepen the recession in not only Greece but many other rich countries, and create a double dip recession. Despite severe cuts, the budget deficit might not improve as further recession decreases tax revenues; this makes it harder to pay the debt back.

A long recession is likely without fiscal stimuli. The uncertainty about the recovery is deterring new investments and hirings. Income and job losses, insecurity, and the pressure to pay back debt is restraining consumption.

The EU’s current policies are assuming that the problem is fiscal discipline. They do not address the structural reasons behind the deficits and the “beggar-my-neighbour” policies of Germany. The austerity packages are pushing the countries...
into a model of chronically low internal demand based on low wages. The deflationary consequences of wage cuts may turn the problem of debt to insolvency for both private and public sectors. In the past, in Germany low domestic demand was substituted by high exports. But it is not possible to turn the whole Eurozone into a German model. Without the deficits of the periphery, the German export market will also stagnate.

Redistribution: the solution to inequality and crisis

The existing wage suppression policies hurt all working people alike. The popular view in Germany misses the fact that the German workers’ loss of wages, unemployment benefits and pension rights created part of the problem in Greece. This is a crisis of distribution and a reversal of inequality at the expense of labour is the only solution.

The governments agreeing to the cuts are avoiding taxing the beneficiaries of neoliberal policies and the main creators of the crisis. The 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. This crisis calls for a major policy restructuring, combining the solutions to inequality with long term aims of ecological sustainability:

a) A highly progressive system of taxes - coordinated at the EU level, on both income and wealth, higher corporate tax rates, inheritance tax and financial transactions tax - is the way to make those responsible pay for the crisis. A progressive income tax mechanism with the highest marginal tax rate increasing to 90% above a certain income threshold could also introduce a maximum income. Debt restructuring can be formulated via a progressive wealth tax on government bonds with the highest marginal tax rate reaching 100% for holdings above a certain amount of bonds; this would make the speculators pay the costs of the crisis.

b) There is need for a correction of the wages to reflect the productivity gains of the past. To facilitate convergence, a minimum wage should be coordinated at the EU level.

c) Higher productivity growth in poorer European countries will help to create some convergence in wages, but regional convergence should be supported by fiscal transfers and public investments in poorer regions. Furthermore, a European unemployment benefit system should be developed to redistribute from low to high unemployment regions. This requires a significant EU budget financed by EU level progressive taxes.

d) Stability and growth pact must be abolished. The ECB should become a real central bank with the ability to lend to member states.

e) Public spending should aim at full employment and sustainability via public employment in labour intensive services like education, child care, nursing homes, health, community and social services, and public investments in ecological maintenance and repair, renewable energy, public transport, insulation of the housing stock and building zero energy houses.

To maintain full employment, a substantial shortening of working time in parallel with the historical productivity growth is also required. This is also an answer to the ecological crisis: for ecological sustainability, economic growth has to be zero or low (equal to the growth of ‘environmental productivity’). For such a regime to be socially desirable it has to guarantee full employment and an equitable distribution; i.e. shorter working time and substantial redistribution via an increase in hourly wages and a decline in the profit share.

f) To finance long term investments, the redesign of the financial sector based on a public banking sector is urgent. Financial regulations, including capital controls, are important but not enough.

g) Public ownership is also required in critical sectors such as housing, energy, infrastructure, pension system, education and health, in which decisions cannot be left to the private profit motive. This should involve the participation of the stakeholders (the workers, consumers, regional representatives, etc.) in decision making and economy-wide coordination of important decisions for a sustainable development based on solidarity.

Dr. Özlem Onaran is Senior Lecturer at Middlesex University, London. Her research areas include globalization, distribution, employment, investment, and crisis.

Corporate Strategy and Industrial Development (CSID)
University of the Witwatersrand
Nicolas Pons-Vignon
E-mail: glc.csid@wits.ac.za