12 April 2012

To: **Executive Council**

From: **General Secretary**

Re: **The Fiscal Compact Treaty – A Synthesis of Views**

Introduction

The special meeting of the Executive Council held on 9 March considered the issue of the Fiscal Compact Treaty. The meeting heard contributions from Prof. Karl Whelan of UCD; Ms Bernadette Segol, General Secretary ETUC; Mr Paul Sweeney, Chief Economist; Dr Tom Healy, NERI and the General Secretary.

Arising from the discussion I was asked to prepare a paper synthesising the different perspectives and identifying key questions that trade union members might reasonably expect answers to before voting in the referendum.

Since that meeting the Government has announced the date of the referendum as 31 May and has also decided on the question to be put to the people.

Context

The original concept behind European integration was, inter alia, to create a Europeanised Germany. In reality the stage is now set for a Germanified Europe. However sincerely Germans may protest that they did not seek, nor do they want, a leadership role in the present crisis, it cannot be denied that the CDU led Government has ruthlessly pursued the adoption of the German model.

Deeper European integration is unavoidable if the Euro is to survive. The institutional architecture put in place to facilitate EMU is deficient. It caters only for monetary union. The implications of deeper economic and fiscal union for Ireland have hardly been discussed. Even for those who favour European integration the fiscal treaty is an incomplete solution. It does not deal with the mutual ownership of debt (Eurobonds) nor with the role of the ECB as a lender of last resort. It is the worst possible basis upon which to be entering such a far reaching project.

It is bad because the project is being recast under the guise of the economic crisis. The shape of Europe as it has existed up to now can be traced back to the Mitterrand era. When he became President of France he tried to construct a socialist polity. A primary instrument for this experiment was the imposition of capital controls. It turned out that the rich could circumvent the regime while the middle class could not. In 1983 Mitterrand did a volte-face. Those in the socialist party hierarchy – people like Jacques Delors, Pierre Bérégovoy and Pascal Lamy – concluded that socialism in one country was not feasible.

Instead they turned their attention to Europe. For historical reasons Germany has always favoured a liberal approach to financial markets. The French accepted this as reality and in fact designed the system of codification of markets that now exists. Everyone thinks this was an American idea. In fact it was the work of French socialists! But for them it was balanced by social Europe. Delors sold the idea extensively and convinced many sceptics.

The problem now is that Delors is gone. Social Europe no longer has champions. The Employment Social Affairs and Inclusion Directorate is marginalised. Strong German/French inter-governmentalism is in possession.

When Joscka Fiscer spoke in Trinity a few weeks ago he argued that the December summit had made a ground breaking decision that was little remarked upon. He referred to an understanding reached that the ECB would henceforth lead on the crisis. His analysis seems to be borne out in the ECB decision to inject €1 trillion into the banking system which has taken pressure off bond yields in recent weeks (although they have begun to rise again in Spain).

But if the ECB is indeed in the ascendant as Fischer suggests then President Mario Draghi's observations in the *Wall Street Journal* are ominous:

> "Europe's vaunted social model – which places a premium on job security and generous safety nets – is already gone".

European elites have long been preoccupied by comparisons with the United States economy. They long for the economic dynamism, productivity and flexibility of the American labour market. It seems only prudent to make a working assumption that conservative and liberal political forces want to press the reset button to bring Europe back to the trajectory it might have followed had Delors' powerful personality not forced social Europe on to the agenda and had social democratic and trade union opinion not been as assured as it was then.

At the moment these forces dominate Europe. Only Denmark and Belgium have social democratic led Governments. The balance could shift significantly if Francois Hollande is elected in France and if the social democrats do well next year in Germany.

But at the moment social Europe is being dismantled via austerity. The prescription is to redistribute income from labour to capital in order to bolster international competitiveness, shore up profitability, encourage investment, and, ultimately, create employment. These are all supply side measures and the fiscal compact treaty is an integral part of the prescription as is the deconstruction of social Europe.

The alternative approach of Keynesian demand management to act in a countercyclical way to boost growth to increase employment is, in effect, made more difficult by the fiscal treaty[1].

The concept of fiscal conservatism is not a new phenomenon in Europe. It is a long standing characteristic of Nordic Social Democracy and Belgium and the Netherlands have aligned their economics with Germany since the 1970's. In the late 1980's Denmark, for example, accepted the policy of pegging the currency to the Deutschmark, liberalising capital markets and accepting a programme of fiscal retrenchment. This led to a gradual reduction in inflation and real interest rates but the absence of control of these levers led to a lack of ability to control unemployment. These difficulties have been addressed by coordinating the economy through keeping market mechanisms embedded in collective agreements thereby giving unions influence on social policies to mitigate the negative

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[1] It is still possible for Governments to decide on the amount of Tax Revenue they collect and the consequent level of public spending that is possible. There is also a body of opinion that holds that Keynesian Economic policies were no longer possible after the experience of the Mitterrand Government and certainly not after the Maastricht Treaty.

effects of monetarism. Even so there is a perspective on this which holds that the unification of Germany created a policy imperative which saw it export deflationary influences which were detrimental to its trading partners in Scandinavia. The problem for Ireland is that we do not have the institutional framework that could help us deal with the unacceptable side effects of tight fiscal discipline. Anyway what is now proposed goes much further than anything seen up to now in Europe.

This then is the context in which we have to make a judgement on the treaty. Unfortunately, matters are not as straightforward as the context suggests. The following key questions are central to the decision.

Key Questions

1. What exactly are we being asked to vote on?
   A Bill will propose inserting the following new Article 29.4.10 in the Irish Constitution:

   "*The State may ratify the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union done at Brussels on 2nd day of March, 2012. No provision of this Constitution invalidates laws enacted, acts done or measures adopted by the State that are necessitated by the obligations of the State under that treaty or prevents laws enacted, acts done or measures adopted by bodies competent under that treaty from having the force of law in the State*".

2. Does the form of the question matter?
   It matters quite a lot. If the Government had chosen to frame the question in a way that would import the actual provisions of the treaty into the constitution then, in practice, we would have been committed to a permanent fiscally conservative polity. The reason is that it would be difficult, if not impossible, to create the conditions for another referendum to reverse the decision. By proposing an enabling clause to permit the Government to sign the treaty it leaves open the possibility of pursuing a different strategy if political conditions should change in the future. That said, the proposed wording is likely to be sufficiently robust to insulate all actions taken in pursuit of implementation of the treaty from constitutional challenge.

3. If the treaty had been in force in 2008 would it have prevented the crisis in Ireland?

   No. Ireland ran a fiscal surplus in every year bar one between 1999 and 2007. Ireland's problems were caused by the banks borrowing excessively from international money markets and funnelling the money into a property boom – a situation made possible by the deregulation of capital markets. In other words, fiscal misbehaviour was not the problem on our part.

4. Is fiscal discipline not a good thing?

   It's a question of degree. Countries should try to keep spending in line with tax revenue over time. Flexibility is needed to deal with problems that arise say at times when unemployment is high and there are more demands on the welfare budget. There is no great merit to fiscal discipline beyond what is sane and sensible in the long run. A structural deficit of 0.5 per cent will be too constraining. Even the Netherlands, a paragon of fiscal rectitude, is finding difficulty reducing its fiscal deficit from 4.5 per cent to 3 per cent at present. Such austere fiscal policies will exert a downward pressure on demand across Europe with consequences for employment.

5. If we are already in an EU/ECB/IMF programme does the fiscal treaty really matter?

   It matters in the long run. There is an assumption that we will be able to extract ourselves from the programme at some stage, but the timescale is uncertain. Acceptance of the fiscal compact treaty would tie us to even more exacting standards of fiscal discipline indefinitely.

6. If we agree to the treaty will Germany allow Eurobonds and the ECB to act as lender of last resort?

   We don't know. There are suggestions that Angela Merkel needs a demonstration of serious intent to persuade the German people to follow through on the other stages of integration.

7. What are the consequences of not accepting the treaty?

   The consequences appear to be very serious. We cannot get access to the new European Stability Mechanism (ESM) unless we sign up to the fiscal compact.

As things stand the State will run out of money by late 2013/early 2014. Unless we are in a position to go back to the markets before then we will need a second bailout. The existing source of funds, the EFSF, will be closed off or integrated with ESM. Unless money is available from some source the alternative would appear to be a Greek style sovereign default while remaining within the Euro. This would involve a fairly quick and brutal alignment of revenue and expenditure with consequences for taxation, welfare and public sector employment.

8. Can we hold up ratification of the treaty?
   By ourselves, no. It requires only 12 of the 17 Eurozone countries to ratify to allow the treaty to proceed. The judgement of the ETUC is that it will be ratified.

   There has been speculation that the Irish Government could indirectly derail the treaty by holding up ratification of the European Stability Mechanism (ESM). To do this would be to cut off our nose to spite our face. If we need a second bailout we will be depending on the ESM to make it available. Up to now the big issue has been Germany's reluctance to put up enough money to create an effective firewall to cover a bailout for Spain and Italy. Only in the last few weeks has a figure of €700 billion been agreed for the ESM.

9. How will the fiscal compact treaty affect pay determination in the future?

   In this respect the main requirement will be to keep inflation rates aligned with or less than those of our trading partners. In the past inflation levels in Ireland ran well ahead of continental Europe. Pay movements followed inflation, thus while German unions were fighting over whether a pay rise should be 1% or 1.2% we were negotiating rises of the order of 3-5%. This was not as out of line as it seems because there was a strong element of 'catch up' involved. Things are changing in Germany too. In the last couple of weeks the public service union, VERDI, negotiated an increase of 6.3% over 2 years. For the future we can expect wage rises to be low in line with low inflation and the machinery of the fiscal compact will seek to keep unit labour costs within strict limits.

Conclusion
Clearly we are between a rock and a hard place and the complexity of our position is recognised by the ETUC. Trade unions in all European countries are against this treaty for good reasons. The problem for us is that we are a programme country with the gun of ESM pointed at our heads.

There are some ameliorating considerations and possibilities:

- A referendum in the form of an enabling question rather than importing the treaty provisions into the constitution does not have quite the same long term implications;

- The possibility of Francois Hollande carrying through on his promise to renegotiate the treaty if elected President of France;

- The possibility of the German Social Democrats insisting on a European programme for growth as the price of their support;

- The offsetting effect on the public finances of a re-profiling of the IBRC Promissory Note;

- The potential of a domestic stimulus programme as proposed by Congress.

Nevertheless, we are left with a troubling dilemma. We would certainly have had to oppose the treaty in the referendum if its provisions were to be inserted into the constitution. The enabling nature of the question at least offers the hope of escaping from permanent austerity if political conditions change. The decision now becomes more finely balanced because access to the ESM is crucial to our economic survival. While the treaty is wrong from our economic and social perspective it becomes hard to oppose it unless a satisfactory alternative to the ESM can be advanced.