

**THE TECTONIC PLATES HAVE SHIFTED:
HOLLANDE ELECTION OFFERS NEW OPPORTUNITIES TO CHANGE COURSE IN EUROPE**

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David Begg, General Secretary, Congress

This morning I would like to share some thoughts with you about Ireland and its future in the European Union.

Last week was the nineteenth anniversary of the death of Pierre Bérégovoy. He was one of an elite group of socialist political thinkers surrounding the last French Socialist President Francois Mitterrand.

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.

When Delors passed from the scene social Europe was left without a champion. The liberal viewpoint remained and came to dominate. Thus, Mario Draghi, President of the ECB was able to say in a recent interview in *The Wall Street Journal* that:

“Europe’s vaunted social model – which places a premium on job security and generous safety nets – is already gone”.

This perspective is reflected in the ECB's attitude towards Ireland. To be sure they opened the tap on a pipeline which supplied €150 billion of liquidity to the banks which kept them on life support during the crisis. But this was motivated by a concern to protect the European Banking System, not to help the citizens of Ireland.

The most extraordinary policy failure by the previous Government was to conflate banking and sovereign debt through the bank guarantee given on 28 September 2008. It has left us with a burden in excess of €350 billion – more than twice our GDP.

The ECB was complicit in that decision and the fact that it will not take its boot off our necks to allow us to ameliorate that debt is reprehensible.

Europe is currently under the control of neoliberal ideologues who are quite willing to press their austerity dogma to destruction – our destruction. We are too small to matter. We are no more than an economic laboratory in which they can try out ever more extreme versions of policies that have already failed. Any notion of European solidarity, for me anyway, dissolved on the streets of Athens.

As well as that the obsession of Europe with austerity is preventing any chance of either debt sustainability or growth. Unless we can find some way to generate growth to lift domestic demand we are in danger of failing.

But please do not misunderstand my perspective on Europe. I believe that European integration is a noble aspiration that transcends the ebb and flow of ideological politics. It was intended to prevent war, to embody the values of the enlightenment and to protect people from the worst excesses of globalisation.

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.

That is why the election of Francois Hollande is so important. The so called 'Merkozy' arrangement was a disaster. Hollande's arrival offers the prospect of a more balanced relationship at the heart of Europe:

- Between Germany and France
- Between Right and Left
- Between Austerity and Growth.

Under Sarkozy, France has underplayed its hand. The willingness to toe the German line has not helped France and it has not helped Europe. A change of tack by France would expose Germany's isolation and increase pressure on it to do what is necessary to prevent a break-up of the Eurozone.

It is hard to avoid the conclusion that the European project is under serious stress. The two major projects of integration - EMU and the Schengen Agreement - are in difficulty. There is no solution to the crisis of the single currency in sight and the free movement of people as immigrants is causing serious social and political tensions in many countries.

No matter what claims are made for it I cannot see that the Treaty will cure any of the causes of the crisis. The problem is though that it contains a poison pill: If you don't sign the treaty you can't get access to the European Stability Mechanism (ESM).

There is very little doubt but that we will need a second bailout. Unless we can afford to borrow again from capital markets when we run out of money next year, we will need to borrow from the ESM.

A number of other critics of the Treaty believe we will be able to get money from the IMF or some other source. Perhaps they are right..... perhaps not!

If they are not right what do we do? What do we do if they do offer money but on terms we can't accept? What if the IMF were to offer us money on higher interest rates? What if they were to require us to bridge the gap between tax revenue and public expenditure as a condition of the loan?

We are talking here of a difference of €16billion between what we take in and what we spend every year. A crash programme to bridge this gap would have horrendous

consequences for public services, employment, welfare payments and personal tax. It could be the tipping point to cause social unrest.

People may say – not unreasonably – that we are being blackmailed and that we should not give in to blackmail. Not giving in to blackmail is what happens in FBI movies, not in real life. What do we say – let them shoot the hostages? There are a lot of hostages to fortune in the uncertainties and the unanswered questions I have outlined.

Some people hold the view that the other countries would not abandon us. Its worth recalling what happened in the 1992 currency crisis when our Central Bank spent most of its reserves propping up our position in the then Exchange Rate Mechanism (ERM) in the expectation that the German Bundesbank would ride to our rescue. They didn't although they did support Denmark – and we had to devalue the Punt by 10 per cent.

Look, when hardy comes to hardy Germany only worries about Italy and Spain, and on the basis of size and impact that is rational.

For four years now we have been on our own. Congress has argued consistently that:

- An export led recovery was not likely in the wake of a banking crisis;
- The most acute problem was the unrelenting fall in domestic demand;
- Domestic demand requires investment and growth;
- That the jobs crisis would only respond to an improvement in domestic demand;
- That the burden of public and private debt could not be sustained without growth.

For all that these fundamental economic truths received no traction, either here or in Europe. The election of President Hollande has changed that dynamic.

There is a view that Keynesian demand management is not possible in current fiscal circumstances. It is an argument which is not entirely without merit but it is not completely true either. To cut to the chase we have to use our ingenuity to get investment into the

domestic economy. That is why we have championed the idea of using some part of the €73 billion in private pension funds to build infrastructure. The attraction of this is that it does not involve borrowing by the State. It can be done off balance sheet.

After all that money is invested all over the world, why not Ireland? It will cut very little ice with workers here to tell them their pension fund earned a fraction of a percentage more by investing it in Brazil rather than in Ireland if they have no jobs to retire from.

Do you recall that a few years ago Mary Harney observed that Ireland was spiritually closer to Boston than to Berlin? Of course we were all up in arms asserting that we are closer to Berlin.

There is a lesson and an irony in this. The lesson is 'Be careful what you wish for'. The irony lies in the fact that President Obama is applying a Keynesian demand stimulus to the American economy – and it is working! The economy is growing, jobs are being created and hopefully he will be re-elected in November

It seems to me that there are only two possible outcomes to the current crisis – either the Eurozone will dissolve or we will move a step further towards a political union.

The dissolution of the Euro would be highly damaging in terms of trade and currency volatility. So much so that I cannot believe that it could ever be allowed to happen.

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.

If indeed we do move towards the alternative of deeper integration it will have challenging implications for foreign policy, fiscal policy, industrial policy and even systems of pay determination and incomes policy. What these might be is really beyond the scope of my

remarks this morning. I am just making the point that this is a more complex issue than the many vacuous slogans of the campaign would suggest.

For the last four years the establishment of Europe have been in the grip of a cognitive lock – a kind of group think that allowed for only one analysis and one solution. They may not have consciously intended it to be so but that solution just happened to put the entire burden of adjustment on working people. They persuaded themselves it would work – even though it was transparently illogical – because it was convenient to let workers make the sacrifices. It was convenient too to press the reset button on Europe. It was convenient to bring us back to a more competitive Europe, a Europe that existed before the social policy dimension insisted on by Jacques Delors and his fellow French socialists.

But the tectonic plates have shifted again. The confluence of the Greek election and the defeat of Sarkozy by Hollande are manifestations of that. The establishment are confronted by a stark choice; persist with a singular policy of dogmatic austerity and bring the house down **or** start buying in to some of our solutions.

Hollande is a serious politician who understands what those solutions mean. He has made clear that he embraces the imperative of fiscal consolidation but he also locates that in its proper context. Austerity has become a mantra without meaning. Fiscal tightening on its own does not improve outcomes in shrinking economies. Austerity is merely begetting more austerity.

Every country has the obligation to manage its public finances prudently and without putting a burden on anyone else. It is not unreasonable to expect countries to observe certain obligations within a currency union. But we also have to face the fact that right now Europe is in deep deep trouble and sooner or later there will have to be a response of a different order.

In short Europe needs a massive growth stimulus and a means of dealing with public and private debt. It needs a new 'New Deal' to comprehend growth, Eurobonds and a new mandate for the ECB that requires it to be – like the US Federal Reserve – both a lender of last resort and a protector of the economy as a whole.

It surprises me that the Government has not made more of the fact that the referendum does not embody the provisions of the Treaty in the Constitution. The question we are being asked is an enabling one; it merely allows the Government to sign up to the Treaty.

If they feel unable, for whatever reason, to defer the referendum then I suggest that they consider giving people an assurance that they will not ratify the Treaty until they have to at the end of the year.

In the meantime they should stand four square behind Hollande and assist him in every way possible to achieve his stated objective of a growth strategy.

Furthermore, they should make growth and investment the theme of the Irish Presidency. Ireland has been a poster child of globalisation and, more recently, a poster child of austerity. Let us seize the opportunity to be a beacon of something good for a change.

I think people would feel more relaxed about the Treaty in these circumstances. It would be a strategy which would give us some influence on our destiny rather than being passive objects of experimentation by neoliberal ideologues. It would put us in the vanguard of the drive for growth while not isolating ourselves from the European mainstream.

Let me explain why we must avoid being isolated at all costs.

Once you become isolated you become like a cork bobbing around in a stormy sea. You can no longer do anything to influence events. Your input is discounted. Nor can we allow ourselves to be lumped in with the Southern European periphery. We must identify ourselves with the small open economies of Northern Europe.

On the other hand we cannot endure the toxin of austerity slowly killing our economy and society. We need to adopt a posture which keeps us in the game to back Hollande. My proposal, I think, has the potential to accomplish that.