

Social Work in European and Transnational Context
Band I

Heinz Stapf-Finé (Ed.)

The Social Dimension of the Economic Crisis in Europe

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Preface

Heinz Stapf-Finé

In 2007/08 the industrialized world faced one of the major economic crises the world has ever seen. Due to the fact that the states invested a lot of money to overcome the economic breakdown Europe is suffering since then a debt crisis. The social consequences are tremendous, in some countries mostly affected by the crisis one is speaking of a lost generation of young people, jobless and without perspective. But even in the countries with better economic performance discontent of the population suffering from austerity measures is rising and the question of a more just redistribution of wealth is fervently discussed.

What is the perception of social work academics and professionals about all this? One might assume that social work is concerned in two ways: First the social situation of the raising number of clients should be of concern. And second the profession itself is victim of social spending cuts thus facing even deteriorating working conditions. In this situation one would assume that the economic and financial crisis and its consequences would be an important point of discussion. But the contrary is true, the profession continues with business as usual.

This was the starting point and motivation of the team of the Europe Institute for Social Work to dedicate the Summer School 2012 to the subject “The Social Dimension of the Economic Crisis in Europe”. A couple of highly experienced experts have been participating and wrote down their findings in the following articles.

First of all it was necessary to get an overview on the economic background of the crisis. Silke Tober in the article “Reluctant Lone Ranger: The ECB in the Euro Area Crisis” works out that the current crisis is the result of drastic austerity measures implemented to restore fiscal sustainability. She characterizes the posture of European governments towards overcoming the crisis as doing “too little, too late”. Since governments and ECB are falsely obsessed by the idea that lack of fiscal discipline is the major cause of the crisis (instead of identifying them in major economic unbalances), they give the patient even more of the false medicine. Thus restoring the economies is only possible if this false thinking can be overcome.

This can only be achieved if the discussion is not only led by economic experts. Thus the article by David Kramer and Heinz Stapf-Finé “Impacts of the crisis on the working conditions of social workers” starts by explaining the main reasons of the economic crisis in a language easy to understand. Three are the main reasons: major economic unbalances, a redistribution of income and wealth from the poor to the rich and deregulation of the international financial markets.

The consequences for social workers are: the already poor working conditions of the profession are getting worse.

Christine Labonté-Roset in her contribution “Social Marginalisation and Poverty” treats the effects of the economic crisis on social cohesion and social exclusion. She states that social work as the profession most closely linked with social welfare needs new concepts of empowering marginalized populations. She shows two successful examples how social work can work in a creative, cooperative and democratic way with excluded people.

“Access to the labor market with special consideration of youth unemployment” is the title of an article written by Alfredo Langa Herrero. Doing a brief study on the case of Spain he shows that as a consequence of austerity policy half of the young people are unemployed and have no perspective for the future. Mostly affected are low and middle skilled people, foreigners and women. He claims that the social consequences of the crisis must be considered in order to avoid dangerous political collateral effects.

The case study of Spain clearly shows that if every second youngster is without a job the problem is a structural one (and not the fault of each individual). Thus the traditionally client centered social work comes to its limitations. José María Morán Carillo in his article “Impacts on methods of social work” even states a deep crisis within the profession: “I understand that one of the situations that have caused some form of crisis in Social Work is a poor management of its theoretical framework, or what is the same, an epistemological deficit that clearly explains who we are and what we do as professionals in social intervention.”

Media play an important role for the (mis-)interpretation of the causes and social consequences of the crisis. In the joint contribution “Media Representation of the Crisis” Ulrike Hemberger critically analyzes the construction of narration and pictures of the crisis: what is excluded in the dialogue in the media, what is displaced and what is hidden concerning the socioeconomic developments? With the example of the film “Inside Job” Wim Franssen shows that the informed and critical use of the media can enhance expertise. How the active work with media used by grassroots movements can create an alternative view on the subject of the crisis is shown in the contribution of Nazan Haydari “Women Workers Strike in Novamed in Turkey: Reconceptualization of the Financial Crisis through Feminist Media”.

We hope that this publication can help to draw an alternative view on the reasons and consequences of the economic crisis. Furthermore the profession of social work needs a creative discussion on the development of methods and on the own working conditions. We hopefully created a positive impulse.

1 Reluctant Lone Ranger: The ECB in the Euro Area Crisis

Silke Tober

Introduction¹

Nearly three years into the government bond crisis, the situation in the euro area is precarious: Unemployment has reached 11.7% with youth unemployment exceeding 55% in both Greece and Spain. The euro area is in recession and in several countries the economic crisis is on the verge of turning into a political and social crisis. In response to the ECB's September announcement of potentially unlimited government bond purchases, government bond yields have fallen from their July 2012 peaks. Nonetheless, government bond yields in many countries remain high: Ten-year government bond yields hover around 4.5% in Ireland and Italy, just below 5.5% in Spain and above 7% in Portugal (December 2012). Although the ECB's key interest rate is at a low 0.75%, the overall financing conditions in these countries are tight. The latter are closely tied to those of government bonds – due to the country risk – and credit institutions have tightened their credit standards nearly continuously since October 2007.

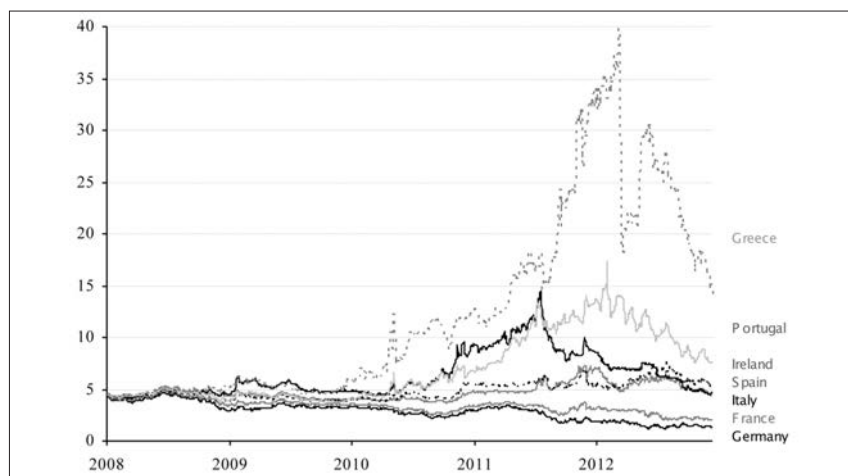


Chart 1: Yields of ten-year government bonds in selected countries, daily, 1 January 2008 –10 December 2012, in %, Source: Reuters EcoWin (EcoWin Financial)

1 Unless otherwise specified the monetary data come from the ECB's database, all other from the AMECO database of the European Commission and the IMF World Economic Outlook. Government bond yields are taken from Reuters EcoWin.

The current recession in the euro area is largely the result of drastic austerity measures implemented to restore fiscal sustainability and regain the confidence of financial markets. The current crisis strategy bears high risks and has already led to tremendous costs in terms of unemployment and forgone production and investment. Governments failed to nip the crisis in the bud in early 2010. As a result, the ECB has had to come to the rescue several times to prevent a severe financial crisis and a break-up of the euro area:

- In May 2010, the ECB for the first time intervened in government bond markets to stabilize government bonds of Greece, Ireland and Portugal.
- In July 2011, the ECB embarked on a second round of government bonds interventions, this time with a focus mainly on Italy and Spain.
- In early December 2011, the ECB announced two refinancing operations for credit institutions with the historically long duration of 3 years.
- In early September 2012, the ECB announced that it would, under certain circumstances, purchase government bonds in unlimited amount.

Given the inadequate overall crisis strategy, the current ECB policy bears considerable risk. The national central banks of the Eurosystem have drastically increased their financing of the banking system, these loans going predominantly to banks in Spain, Italy, Greece, Ireland, and Portugal. The large and skewed refinancing needs are the result of the current confidence crisis. Had the ECB not stepped in, the banking systems in these countries would have collapsed. The sooner the crisis is resolved, the more likely it is that the risks incurred will never materialize. The key question is how this crisis can, at this point, be rapidly overcome.

The key to resolving the crisis lies in restoring confidence in the government debt of all euro area countries. It has become clear that fiscal austerity measures are unable to bring this about, especially if fiscal restriction is implemented in all countries simultaneously. The only way to restore confidence rapidly is for euro area governments to give some sort of guarantee for the government bonds of the crisis countries. One viable option would be to set up a redemption fund that guarantees all euro area debt in excess of 60% of national GDP.² The national governments would service their respective debt but interest payments would be considerably lower. Such a guarantee would also give the ECB the political backing it needs to effectively intervene in government bond markets. A guarantee of this sort would eliminate the risk of a breakup of the euro area and of

2 A debt redemption fund was first proposed by the German Council of Economic Experts (2011, p. 3ff. and p. 106ff.). To be successful it should be modified to make the scale of debt repayment dependent on the stage of the economic cycle.

debt restructuring. As a result, financing costs in the troubled countries would decline and the expansionary monetary policy stance would finally be effective in these economies as well.

Given how entrenched the crisis has become, this alone will not suffice to stabilize the economies of the euro area. Fiscal consolidation must be spread out over time and accompanied by a growth strategy that allows for a reduction of the current account imbalances within the euro area.

Piecemeal strategy of minimal action

In the first months of 2010, investors in Greek government bonds increasingly lost confidence in the value of their investment. Yields had already risen considerably since October 2009, when the newly elected president Papandreou announced that the previous government had understated the size of the budget deficit. At close to 7%, the return demanded by investors for ten-year government bonds was too high for Greece to finance its fiscal deficit and refinance due debt. Whereas French president Sarkozy and the president of the EU Commission Barroso wanted to quickly lend a helping hand to Greece, German Chancellor Merkel initially refused to grant any financial assistance. In late February 2010 she explained on German TV that Germany could best help Greece by “making clear: Greece must do its homework.”³ In March 2010 she conceded the possibility of emergency loans, albeit as a last measure (“ultima ratio”). The Greek fiscal deficit for the year 2009, that had been put at 3.7% in mid-2009 and revised to 12.7% in January 2010, was further revised in April 2010 to 13.5% of GDP. (The IMF currently publishes a figure of 15.6%). Correspondingly, the government debt ratio initially put at 113% was successively increased to a final 127% of GDP. Measures implemented to reduce the deficit in February 2010 were also repeatedly tightened. Rating agencies reduced the rating for Greek government bonds several times and the economic situation got increasingly worse. Having declined by 3.3% in 2009, GDP dropped by 3.5% in 2010, only to continue to fall in 2011 and 2012, by 6.9% and 6%, respectively.

Greek governments had undoubtedly made serious economic policy errors in the past, not least in neglecting to adequately tax higher income groups. It was nevertheless a grave policy mistake on the part of euro area governments to not assist Greece rapidly. Firstly, deep-seated structural problems in the economy and tax system cannot be solved quickly but require time. Secondly, Greece’s ability to reform was hampered by the high and rising yields demanded in the financial markets. Thirdly, the combination of high yields and fiscal austerity brought on a vicious cycle of declining economic activity, deteriorating bank balance sheets

3 ARD, Bericht aus Berlin, 28.2.2011, translated by the author.

and weakened public finances which, in turn, led to higher yields and additional fiscal cutbacks. Fourthly, it was foreseeable that the lack of solidarity would alarm investors and reduce their willingness to hold government bonds of other euro countries exhibiting high budget deficits or large debt ratios.

The risk of contagion was especially great because the industrialized countries were in the first year following the Great Financial Crisis and Recession. Despite large interest rate cuts and expansionary fiscal policies, euro area GDP had declined by 4.7 % in 2009 and public debt ratios had risen in all euro countries, in part because the state covered losses incurred by the banking sector.

Despite this fragile initial setting, the heads of government in spring 2010 were reluctant to resolve a potentially explosive situation in a country whose entire government debt amounted to a mere 3.6 % of euro area GDP. Some governments, Germany's in particular, feared moral hazard, i. e. that member states in general would adopt lax fiscal policies in the hope of bailouts. Greek ten-year government bond yields climbed above 7 % in early April 2010 and, on 23 April 2010, the Greek government saw no alternative to officially asking the EU for help. The rescue package passed by the governments on 2 May 2010 had a loan volume of 110 billion euros tied to strict conditionality and made up of loans from the EU and the IMF as well as bilateral loans from EU countries. Greece committed itself to reducing the fiscal deficit from 13.6 % of GDP in 2009 to 2 % in 2014. The interest to be paid by Greece was 5.5 % – not only far above the refinancing costs but also too high for a country in economic distress.

Markets were not impressed by the rescue efforts. Yields rose above 10 % on several days in end-April and early May. On Friday, 7 May 2010, yields of ten-year Greek government bonds reached the hitherto highest level of 12.3 % and yields of Portugal, Spain and Italy also tended clearly upwards, whereas corresponding German yields had declined to 2.8 %.

Faced with deteriorating conditions in the market for Greek, Irish and Portuguese government bonds and the imminent risk of contagion to other countries, the ECB decided to step in. On the following Monday, the national central banks of the Eurosystem⁴ intervened for the first time in government bond markets – four days after ECB President Trichet had stated at the monthly press conference that such a measure had not even been discussed during the ECB Council meeting. On the same day, German Bundesbank president Axel Weber publically criticized the decision of the ECB Governing Council. The markets were also not calmed by the announcement on 10 May 2010 of a rescue fund holding 750 billion euros in funds and guarantees by euro countries, the IMF and the EU. In May 2010, the idea of a split of the euro area into North and South broke ground. The yield

4 The European Central Bank (ECB) and the national central banks of the 17 countries that have adopted the euro make up the Eurosystem.

differentials between the countries in crisis and Germany rose week after week. Political decisions steadily failed to keep up with market developments and Germany repeatedly waited until the last minute to relinquish its refusal to act. The decisions, ultimately taken under market pressure, were not suited to restore confidence in the stability of the euro area economy.

Yields again jumped upwards in October 2010, when Chancellor Merkel publically called for private sector involvement in resolving government debt problems. Although the proposal concerned the European Stability Mechanism to be established in 2013 rather than the immediate future, the proposition unsettled holders of government bonds of the crisis countries given the latter's strained economic and financial state. ECB president Trichet and others had warned in vain of the dangers involved in evoking debt restructuring, especially the risk of contagion to other euro area countries.⁵ Ten-year government bond yields in Greece, Ireland and Portugal rose to 11.5 %, 8.1 % and 6.8 %, respectively. In the same month, Ireland became the first country to receive aid from the newly created European Financial Stability Facility (EFSF). Until the end of the year, the ECB purchased Greek, Irish and Portuguese government bonds on the secondary market for 74 billion euros and all three countries tightened their fiscal policy stance even more. Nonetheless, yields continued to rise. In May 2011, Portugal became the second country to ask for assistance from the EFSF and the IMF.

The economic situation in Greece worsened. In July 2011, euro area governments agreed on a second rescue package for Greece amounting to 109 billion euros and tied to a substantial haircut of Greek government debt to be borne by the private sector.⁶ Initially the private creditors' involvement was to be voluntary, based on one of three models involving a mix of debt prolongation and interest rate reduction and resulting in a debt forgiveness of 21 % of the nominal value of the government debt. Soon thereafter, investors started to sell off Spanish and Italian government bonds. In early August 2011 the yields of ten-year government bonds climbed above 6 % and the ECB announced that the national central banks of the Eurosystem would begin to purchase bonds issued by these two countries. Within two months the Eurosystem increased its holdings of government bonds "held for monetary policy purposes" by 89 billion euros to 163 billion euros. The ECB thereby prevented further increases in yields as well as a further deterioration in bank balance sheets and enterprise financing. Yields temporarily even declined by one percentage point. In September 2011, Spain adopted a constitutional amendment committing governments to stricter fiscal discipline

5 ECB (2011), *The Economist* (2010).

6 This sum includes the undisbursed funds of the first rescue package but not a short-term credit line of 35 billion euros for the Greek banking system. Governments also decided to lower the interest rate on loans already granted to Greece, Ireland and Portugal.

and Italy enacted a three-year public government savings program. The euro area as a whole headed for recession and rating agencies no longer cited high debt but rather the worsening economic outlook as the main reason for downgrading country ratings in the euro area. In Germany – viewed as a “safe haven” – yields declined: In the fall of 2011, the German government had to pay only 2% interest on a newly issued ten-year government bond. In contrast, the situation worsened in the crisis countries. The number of politicians making dramatic appeals increased markedly. The president of the EU Commission, Barroso, declared that the European Union faced its greatest challenge to date, IMF president Lagarde urged the euro area countries to “act now and act together”, German Chancellor Merkel and ECB president Trichet spoke of the “worst crisis since WWII” and U.S. Treasury Secretary Geithner appealed to the euro area governments to erect a firewall to prevent the crisis from spreading further.

In early October 2011 the ECB announced a one-year refinancing operation, reversed the rate hikes of April and July 2011 by 0.5 percentage points and halved the minimum reserve requirements. At the end of October the governments increased the funds available to the rescue fund EFSF. They also agreed on the Fiscal Pact to be enshrined in national law and committing national governments to strict fiscal discipline. These political acts did little to stabilize the markets. The Greek haircut weighed too heavily, all the more so as the private sector’s debt forgiveness was raised from 25% to 50% in October (ultimately it was 53.5% in March 2012 without the possibility of choosing between options as envisaged in July 2011). At the end of November 2011, ten-year government bond yields rose to above 7% for Italy and to 29% and 13% for Greece and Portugal, respectively. Furthermore, the euro area was faced with a looming credit crunch.

Against this background, in December 2011, the ECB once again came to the rescue and announced far-reaching measures, in particular, two three-year refinancing operations and a reduction in the collateral requirements.

Skewed allocation of refinancing operations and high Target2-balances

The ECB’s conventional and unconventional policy measures prevented the crisis from escalating further and, ultimately, a breakup of the euro area. At the same time, however, they also increased the risks attached to the assets held by the Eurosystem. This applies, for example, to governments bonds purchased since May 2010 to stabilize the price and yield of government bonds. In late November 2012 the Eurosystem held bonds for monetary policy purposes in the amount of 208.5 billion euros. To similarly support banks the Eurosystem also purchased covered bonds that at the end of November 2012 were worth 68.5 billion euros. The greatest build up of risky assets occurred through the expansion of refinancing loans to credit institutions. These increased dramatically already during the inter-

national financial crisis 2007/2009. At that time almost all banks were affected by the loss in confidence. Banks, weary of the ability of other banks to repay loans, stopped lending each other money in the money market. They therefore had to satisfy their refinancing needs to a greater extent via central bank credit. As the international financial crisis abated and confidence returned these refinancing needs declined. In the course of the government bond crisis in the euro area the need of central bank refinancing again increased, surging with each escalation of the crisis. With the two three-year refinancing operations in December 2011 and March 2012, the Eurosystem lent banks a total of 1019 billion euros. In part, these were substituted for shorter-term loans; nonetheless refinancing operations increased altogether by almost 500 billion euros. They reached an all-time high of 1235 billion euros in July 2012 (Chart 2). Furthermore, total central bank refinancing no longer consists of only regular refinancing operations but includes emergency lending operations as well, for which only the national central bank bears the risk. In Chart 2, the latter are proxied by “other claims on euro area credit institutions”.

Not all banks are equally dependent on central bank refinancing. Primarily, it is the banks in the crisis countries that require funds directly from the national

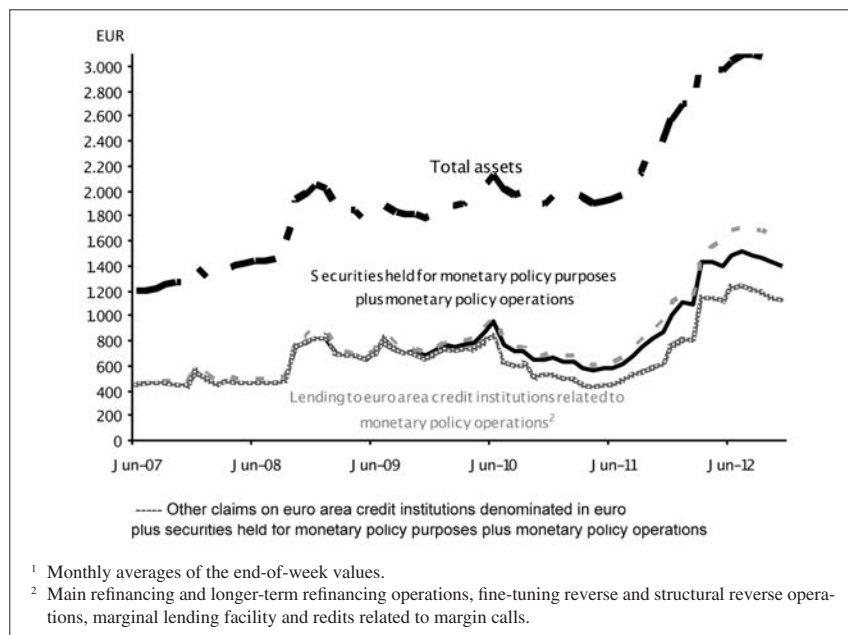


Chart 2: Consolidated Financial Statement of the Eurosystem, January 2007 – November 2012,¹ in billion euros, Source: Weekly Consolidated Financial Statements of the Eurosystem, European Central Bank

central bank. In Greece, banks increased their central bank refinancing from 4 billion euros to 129 billion euros between January 2008 and October 2012, in Ireland from 31 billion euros to 119 billion euros, in Italy from 14 billion euros to 276 billion euros and in Spain from 41 billion euros to 369 billion euros. This contrasts with the demand in those countries, like Germany, that experienced an inflow of capital and consequently reduced their lending from the national central bank. In January 2008, credit institutions in Germany borrowed 178 billion euros from the Deutsche Bundesbank, in November 2012 only 77 billion euros. The steep increase in central bank refinancing is mainly the result of a lack of other sources of financing. Interbank-loans are scarce and domestic bank customers are withdrawing deposits, in part to deposit them abroad. This outflow of capital is mirrored in the liabilities of the respective central banks towards the central banks of euro area countries experiencing capital inflows. It is processed through a payments system called TARGET2 (Trans-European Automated Real-time Gross Settlement Express Transfer System). If investors pull money out of their account at an Italian bank and deposit it in an account at a bank in Germany, this is an international transaction that affects the balance sheet of the respective national central banks. At the end of each business day these assets and liabilities are transformed into assets and liabilities toward the ECB. Prior to the international financial crisis Target balances were negligible; in August 2012 they reached record levels: The German Bundesbank sported Target2 assets of

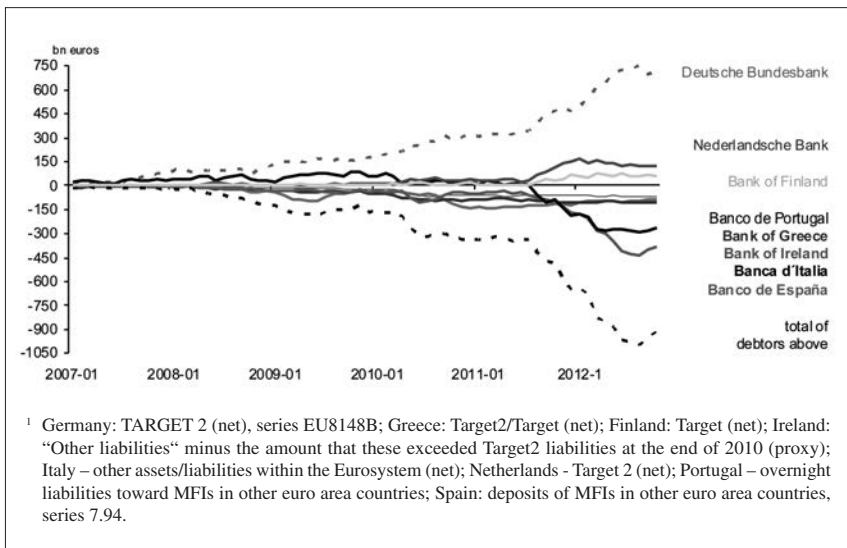


Chart 3: TARGET2 balances of selected national central banks of the Eurosystem¹, January 2007–October 2012, end-of-month, billion euros, Sources: Financial Statements of National Central Banks