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## The political consequences of the economic crisis

### Committee Opinion<sup>1</sup>

Committee on Economic Affairs and Development

Rapporteur: Ms Anna LILLIEHÖÖK, Sweden

### A. Conclusions of the committee

The Committee on Economic Affairs and Development congratulates the rapporteur, Mr Zingeris, and the Political Affairs Committee on this important report which it fully endorses. The committee believes that the scale and political consequences of the economic crisis demand swift and sound economic responses which preserve citizens' economic and social rights in the face of all the challenges facing the Council of Europe's 47 member states. The responses to the crisis cannot be national or even European. They must be global. In this respect the committee calls for a paradigm shift in the management both of financial flows and of public finances, and stronger policies for stimulating employment. The Committee on Economic Affairs and Development welcomes the proposal put forward by the Political Affairs Committee to organise a joint hearing on the political impact of the economic crisis on the European society.

### B. Explanatory memorandum by Ms Lilliehöök, rapporteur

#### 1. Introduction

1. The financial and economic crisis which started in the United States in 2007 before spreading to the entire planet, including the Council of Europe's member states, has been the most striking development in economic terms in recent decades and since the 1929 crisis. It triggered a serious world recession which is hitting national economies hard and whose impact can be felt on economic, monetary and also social policies, given the rise in unemployment and the austerity plans which have been announced. More serious still are the first signs of political protests, which mean that extreme care will have to be taken over the coming months and governments will have to be made aware of the importance of the solutions to be adopted in managing the crisis.

2. The Political Affairs Committee's report clearly highlighted the advances made by various extreme right parties in recent elections, for instance Jobbik in Hungary, which now has 47 members of parliament. This success is one of the first political consequences of the economic crisis, which once again reflects the response at the ballot box of people who have been hard hit by the economic effects of the crisis and who lay most of the blame with the incumbent governments.

3. From a strictly economic point of view – even though economics and politics are increasingly interlinked – the political consequences of the crisis stem from rising unemployment, the freezing of public sector pay, declining purchasing power and pessimism about future developments. There are continuing questions about the solvency of states in spite of the various measures taken at European level and about the long-term political ability to create frameworks for balanced and sustainable economic development in many countries.

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1. Reference to committee: [Doc. 12066](#), Reference 3625 of 25 January 2010. Opinion approved by the committee on 18 June 2010.



As the effects of the crisis on employment represent a particularly serious risk of political unrest, it is necessary to strengthen public confidence in future economic development with a prospect of more and better jobs.

## **2. Phase 1: excessive household debt**

4. The economic crisis began with the now infamous sub-prime crisis, which was brought about by banks and other lenders granting mortgage loans to individuals without properly checking the latter's ability to pay them off. These toxic loans were subsequently reinvested in other financial institutions. The system collapsed when the loans could no longer be honoured, leading to the bankruptcy of many financial institutions.

5. The crisis quickly had an impact on the public because of the resulting credit crunch. As consumption and investment collapsed, the impact of this initial phase in the crisis was felt in the employment market (rising unemployment) and the operation of public services. To prevent bank failures, the authorities bailed out financial institutions, reallocating funds from other projects while also nationalising some banks.

6. However, governments were confronted with rising public debt while having no immediate possibility of increasing revenues. Several countries were faced with stock-market speculation against their debt which was believed to be safe but in reality was not. As this situation became clear, some of them were downgraded by the rating agencies because of their limited ability to repay funds borrowed on the markets that were needed to finance their public debt. Several countries with high budget deficits in relation to their GDP therefore ended up facing the possibility of being overwhelmed by their debt burden.

7. The Committee on Economic Affairs and Development has lost no time in looking into the issue of the political consequences of the economic crisis, both in previous reports and in those currently under preparation such as the one on "Over-indebtedness of states: a danger for democracy and human rights" (rapporteur: Pieter Omtzigt, Netherlands, EPP/CD). Moreover, its report<sup>2</sup> debated during the plenary session of the Parliamentary Assembly of the Council of Europe in January 2009 underlined that "governments should be reminded that, despite financial difficulties, citizens' social, economic and human rights must be safeguarded in order to avoid undermining the very foundations of democracy".

## **3. Phase 2: excessive government debt**

8. At the start of 2010, the economic crisis entered a second phase involving a development that is much more critical as regards the democratic stability of the various Council of Europe member states and has much more worrying political consequences: excessive government debt.

9. The G20's declarations on regulating international finance were not followed by action and many banks and financial institutions, which had been bailed out with public funds at very low interest rates, believed there would be a return to "business as usual". However, this was to ignore that the crisis would reveal the mismanagement and the imbalance of public finances which was highlighted by the rating agencies. Consequently, countries such as Greece, Spain and Portugal, and then the whole of Europe, were plunged into a state of anxiety which, in many places, turned to public anger.

10. For although international finance had been an ideal scapegoat – sometimes rightly so – for the 2008 financial crisis, political leaders in problem economies could no longer hide the imbalances and poor long-term economic policies built up over the last twenty years. The current economic consequences have highlighted the dangers of short-sighted and risky economic policy management where inadequate tax policies are combined with overspending (that is, as regards expanding social benefits, underfunded pension schemes, excessive increases in numbers of public servants and extravagant public authority management). Insufficient attention to policies for sustainable growth in jobs and economy to secure private income and fiscal revenue aggravated such imbalances. This shows the importance of good governance and basic frameworks for fiscal balance at national level, such as the criteria fixed by the European Union's Stability and Growth Pact. As the earlier-mentioned report by Mr Sasi points out, sound macroeconomic policies that help to resist economic crises can be an important factor in how the functioning of democracy is perceived.

11. Whereas, for electoral purposes, many European leaders often used to attack the "diktats" of the European Union and the European Central Bank (ECB) concerning the Stability and Growth Pact, which limited public deficit to 3% of GDP, and the single currency, they are not shouting out now. Once the

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2. The consequences of the global financial crisis (rapporteur: Kimmo Sasi, Finland, EPP/CD), [Doc. 11807](#), 27 January 2009.

sacrosanct rule of the stability pact had been flouted, public expenditure took off in many countries, even though the economic growth needed to offset public debt is still failing to materialise as a result of the recession triggered by the sub-prime crisis in 2008.

12. These economic policies led many Council of Europe member states into a vicious spiral that was reflected in economic terms in increased requests for support from the European Commission and, above all, the International Monetary Fund (Hungary, Ukraine, Iceland, Latvia, Romania, Poland, Bosnia and Herzegovina, Serbia and Greece). In monetary terms, for the countries using the euro, the steady decline in the currency – which fell under the US\$1.22 mark on 19 May 2010 – caused worrying falls on stock markets and is severely penalising exports. In other countries, the slide in currencies such as the Hungarian forint and the Icelandic krona resulted in devaluation and a sharp rise in inflation rates. In Iceland, inflation rose to almost 14% in October 2008 and the country was obliged to borrow €4 billion from the Russian Federation in order to increase its exchange reserves and stabilise its currency.

13. Apart from the impact of these monetary problems on individuals' purchasing power, these excessive government debt levels have prompted the rapid implementation of austerity policies affecting people already suffering under the difficult economic conditions. In some countries such as Spain, for instance, unemployment is touching 20%.

#### **4. Austerity policies and political conflict**

14. Many demonstrations against the austerity policies have been held. Thousands of people demonstrated against “capitalism” in Madrid on 16 May 2010. In Greece, several days of strikes and demonstrations led to clashes with police in Athens, where three people died in a bank which had been set on fire by an angry crowd on 6 May 2010.

15. The various measures taken by certain governments (Ireland, Portugal, Greece, Spain, Hungary, Romania, United Kingdom and Italy, etc.) in response to the crisis include freezes or actual cuts in public sector pay until 2013. Retirement pensions have also been frozen, the retirement age has been raised and some child benefits and allowances have been abolished. There have been widespread increases in taxation, both direct and indirect (VAT), and budget cuts are also affecting the areas of international co-operation, local government and the reimbursement of medical expenses.

16. However, some economists have serious doubts about the appropriateness of these austerity measures because they believe that they could have irreparable social consequences and thereby lead to serious political problems. All the more so since they would have a counterproductive economic effect, as economic growth would no longer be stimulated and debt levels would persist. Bankruptcy would only be delayed and would take place in an extremely tense political and social climate.

17. Lastly, according to the American economist, Nouriel Roubini, “what is happening today in Greece is the tip of the iceberg of rising sovereign debt problems” in many developed countries.<sup>3</sup> In his view, a global government debt crisis is possible. One can only imagine the political consequences of such a crisis.

18. The example of Argentina in 2001 should be taken very seriously. It bears a number of similarities to what is happening economically in Greece. As the public debt situation had deteriorated (almost 15% fall in GDP), the Argentinian Government, acting on IMF advice, took drastic measures such as cuts in social expenditure and civil servants' salaries and the freezing of savings accounts, which resulted in violent demonstrations in Buenos Aires. On 19 and 20 December 2001, a state of siege was declared after a security forces clampdown that claimed the lives of 35 people and led President Fernando de la Rúa to flee from the presidential palace and then resign.

#### **5. Conclusion**

19. Economic crises always have political consequences in the short, medium and long terms. The 1929 economic crisis was one of the factors – but not the only one – that led to extremist movements taking power, often legally, and European economies being geared towards the preparation of a war which devastated our continent and the whole world.

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3. *Le Monde*, 19 May 2010.

20. At a time when the choices that the various governments will make to tackle the economic crisis will be decisive, Council of Europe member governments must all join together in drawing the lessons from a not so distant past to avoid repeating the tragic mistakes of an era when an economic crisis triggered terrible political and human consequences.