

Die Spaltung Europas durch die Eurokrise

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**Dr Alfred Kleinknecht,
Emeritus Professor of Economics (TU Delft)
& Senior Fellow of WSI (Hans-Böckler-Stiftung)**
alfred-kleinknecht@boeckler.de

Historical background: After the Great Crisis (1929-1941)

A “Golden Age of Capitalism” (1946- ca. 1973):

- Unprecedented economic growth
- Low unemployment
- Low inflation
- Income distribution perceived to be fair
- Fairly stable financial markets

The Age of Keynes!

Broad consensus:

- Manchester capitalism is passé
- Economic stability through fiscal and monetary policy
- Solid regulation of financial markets
- A decent security net

After the “Golden Age” (1946-73) there is a turning point around 1975-1985:

- **Slowdown of economic growth**
- **Fiscal stimulation seems to become inefficient**
- **Oil price shock en “Stagflation”**
- **Growing government debt burden**
- **Keynesian macro-models make tough forecasting errors**

All this was a fruitful breeding ground for an anti-Keynesian counter-revolution from the right:

Supply-side economics!

Supply-side economics (1):

- **Passive economic policy: no more fiscal stimulation; only monetary policy for fighting inflation**
- **Striving for greater income inequality: “Performance must pay!”**
- **Deregulation of labor markets: easier firing!**
- **Cutting back on social security (“it makes people passive!”)**
- **Retreat of government: deregulation, liberalization, privatization; Hayek (Nobel Prize 1974): “Minimal State”!**
- **Deregulation of financial markets: more room for financial innovation!**
- **Markets are never wrong ... and government is at the roots of every problem!**

Supply-side economics (2):

**NAIRU = Non-Accelerating
Inflation Rate of Unemployment**

**Mission of the ECB: fight
inflation at any price!**

**Theory of ‘Natural Unemployment’ → You need a rate of unemployment that ensures sufficient competition for jobs → prevent a wage-price spiral (inflation)
For example: Germany “needs” about 6% “naturally” unemployed**

**From a NAIRU viewpoint, high unemployment in Southern Europe is not a problem ... but part of a solution:
Stronger competition for jobs → less solidarity, weaker trades unions → room for supply-side “structural reforms” → downwardly flexible wages allow for higher employment!**

Supply-side economics works: Greater inequality!

Share in National Income in the US:

Of the richest 10%:

- **33% in 1976**
- **50% in 2007**

... and of the richest 1%:

- **8.9% in 1976**
- **23.5% in 2007**

Source: Atkinson, Piketty and Saez (2011)

Supply-side economics ...

October 2013:

Nobel prize for Eugene Fama (Chicago School), Founder of the 'Efficient Market Hypothesis'.

How can the theory of Fama be reconciled with the reality of the financial crises (2008-today)?

If theory does not fit reality, we need to change reality!

→ *We need “structural reforms” of markets!*

The US mortgage crisis

- **This is a non-regular crisis of over-speculation. Such crises happen quite frequently in history, but often they are confined to certain markets or countries.**
- **This crisis is "historic" as it takes place at World-scale**

Historical examples:

- **The Railway Crash 1873-5 → Great Depression (1875-1890's)**
- **The 1930s depression (1929-1941)**
- **The Japanese crash of 1989 and long stagnation**

Building blocs of this crisis (1):

Largely agreed upon:

- **Bonuses that encourage ruthless speculation**
- **Risky leverage financing of speculative businesses**
- **Implicit government bail-out guarantees for banks that are 'too big to fail'**

Still under-researched:

- **Failure of Rating Agencies: much too optimistic ratings of bundles of mortgages (client-friendliness? corruption?)**

Building blocs of this crisis (2):

What received little attention in the dominant discourse:

- **Regulating authorities have become weak after a long campaign for the retreat of government, the "deregulation" and "liberalization" of markets**
- **A World-wide "savings glut" (Ben Bernanke): excess savings searching for investment opportunities → building up asset bubbles (petrol money; high savings of rich people).**

Macro economic background of the US mortgage crisis:

US Import surplus:

➤ **Exports minus imports (billion US \$):**

Ca. 7% of US National Product!

| | |
|-------------|----------------|
| 1991 | - 31,1 |
| 1995 | - 104,0 |
| 2000 | - 379,8 |
| 2002 | - 423,7 |
| 2004 | - 612,1 |
| 2005 | - 714,4 |
| 2006 | - 758,5 |
| 2007 | - 711,6 |

Note: A deficit on the current account needs to be compensated through selling of assets (capital account)

- **In recent years, US assets sold to foreigners consist increasingly of bonds issued by US firms and the US government – and of mortgage-based securities!**
- **Within the US, the growing national debt translates into debts of individual actors such as:**
 - **government (national debt),**
 - **firms (bonds, bank loans) or**
 - **private citizens' debts (mortgage debt; consumer credit; credit card debt)**

How long can you continue building up debt?

Quite long:

Export surpluses and import surpluses are equal to each other on a World scale → There is, by definition, enough money to lend and borrow, as long as the surplus countries are ready to lend to the deficit countries.

Credit, however, depends on trust ...

Solutions:

- **Americans have to consume less and save more (higher exports, lower imports)**
- **The export-led economies of Europe and Asia have to do the exact opposite: higher domestic consumption and lower savings!**

Finally: Why did so many people not foresee the emerging debt crisis? (1)

- **Strong believe in stable and efficient markets**
 - **Markets are stable: they always strive towards equilibrium**
 - **Markets are efficient (welfare maximizing outcomes)**
 - **Actors are rational and act in the interest of their firm.**

Dominance of micro-economics above macro-economics + fading memory of the 1930s

Why did so many people not foresee the emerging debt crisis? (2)

- As long as a bubble is building up, there is a lot to be earned!



***“We had to dance as long as the music was on!”
(A Lehman banker)***

- Long tails: If the Black Swan appears, consequences are disastrous – but the probability that it will appear is quite small

US: Domestic debt as a percentage of GDP (1950-2007)

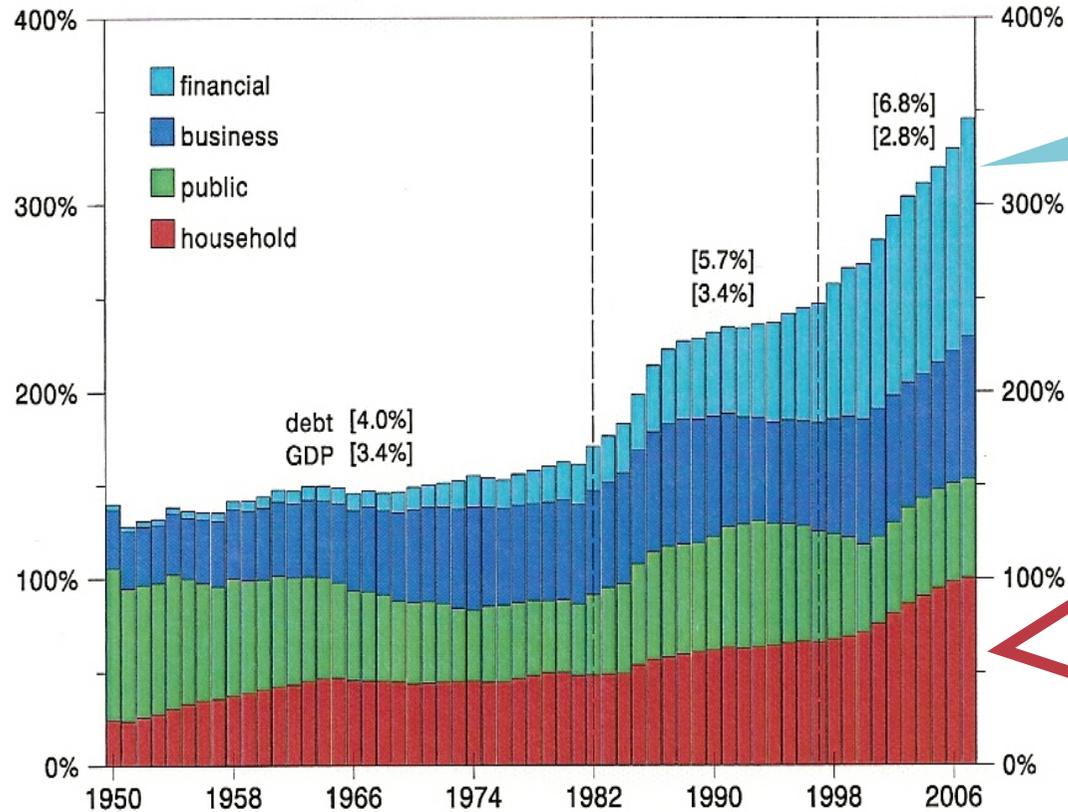
"Household" = Consumer and mortgage debt

"Business" = Total non-financial business sector debt

"Financial" = Total financial sector debt

"Public" = total public sector debt (local and federal)

Source: US Federal Reserve



Leverage financing!

Rapid rise in housing prices → higher mortgages

Summarizing: There were strong indications of a coming crisis (for those who wanted to see them):

- **A growing debt burden in the US: Earlier or later, the chain of credit had to brake (at its weakest link)**
- **A high value of Tobin's Q in the US stock exchange (comparable to the value in 1929!)**

Why was this not seen (by so many 'experts')?

Theoretical convictions and ideological beliefs influence perception of statistical facts

... and many professors of finance earned good money advising Wall Street ...

Finally:

The drama of the Mediterranean countries ...

- **After their accession to the EU, they had higher growth rates than the Northern countries!**
- **But this was only possible as they could devalue their currencies from time to time ...**
- **... devaluation makes your export cheaper, and your import more expensive**
- **... and that helps avoiding excessive import deficits**

The key problem:

Since the introduction of the Euro, devaluation is no more possible!

→ Mediterranean countries build up ever higher import surpluses ...

... and these surpluses were/are financed mainly through credit!

What market fundamentalist don't tell you ...

Failing financial markets: 'our' financial sector gave easily credit, being blind for risks ... while the debt burden grew dramatically

They failed asking risk premiums which could have discouraged borrowing ... so borrowing went on, at low interest rates, until the bubble exploded

... and Rating Agencies were sleeping: Mediterranean countries had solid A-ratings until short before the crisis!

“Framing” of the political discussion:

- **Lots of concern about governments with high debts, but little is said about banks lending too much**
- **Emphasis on governments as easy spenders: How can we enforce budget discipline?**
- **... but there are just two countries that have a problematic government debt (Greece and Italy); in other countries, private debt is the problem**
- **Many countries reduced their government debt after accession to the Eurozone...**
- **... but debt (as a percentage of National Product) rose again after the Lehman Crash in 2008**

An alternative diagnosis:

- **Germany and the Netherlands brought Mediterranean countries into difficulties through an aggressive export policy**
- **Their export surpluses created lots of extra jobs in Germany and the Netherlands ...**
- **... but destroyed jobs in the Mediterranean countries: the rich steel jobs from the poor!**
- **... and our financial sector provided cheap and abundant credit which allowed them paying for their import surpluses**

You could see long ago that this had to end in a credit crisis! (see e.g. early warnings by Heiner Flassbeck!)

Right-wing solutions: strong austerity!

Quickly rising unemployment and cuts on social security

Logic of the theory of 'natural' unemployment (NAIRU)

Strong competition on scarce jobs: breaking the power of trade unions and the left ("never waste a good crisis!")

More political room for "Supply-side politics" → Cuts on social security → downwardly flexible wages → more employment!

Right-wing solutions: Deflationary policy!

- **In Mediterranean countries, the general price level has to go down in order to make them competitive again**
- **... this requires downwardly flexible wages, defeating the trade unions and easier hiring and firing ...**
- **... but when prices decline, consumers postpone their spending, waiting for lower prices ...**
- **... which brings the economy even deeper into crisis – and this diminishes possibilities for debt-repayment ...**
- **... and unpaid debt has, in the end, to be born by European tax payers**

Food for right-wing populists: “Our tax money is wasted by lazy people in Southern Europe!”

Three routes to an alternative solution:

1. **Hard commitments (with automatic sanctions!) that the Germans and the Dutch learn how to behave → More domestic consumption and lower savings in Germany and the Netherlands (= lower exports, higher imports)**



... and the opposite needs to happen in the Mediterranean countries!

Three routes to an alternative solution

- 2. Trade unions should coordinate their wage claims: strong wage increases in export surplus countries; low wage claims in countries that have import surpluses!**
- 3. More European solidarity: every currency union in the World has a public budget for “backing-up losers”: The rich have to support the poor!**

And if all this turns out impossible ... if nationalism prevails?

Then split the Eurozone into a Euro-North and a Euro-South with a (Bretton-Woods-type) exchange rate between them.

... or, if that is not feasible: let individual countries exit the Euro (in a well-managed way)

This is still better than the current practice → there is a risk that anti-European populists gain momentum!

A remaining risk:

Governments backing up speculators ...

Many banks are still “*too big to fail*” → they have an implicit bail-out guarantee by governments



If you accept more risks, you make higher profits ... and hence the implicit bail-out guarantee gives an incentive for ruthless speculation:

Profits are private

Losses are for tax payers

Solution: Better banking regulation

... realize that government budgets cannot be charged by a second round of bank rescues

Regulators should be given the power to force banks rescuing themselves: Selling new shares and bonds + force a bank's bond and shareholders to buy them

Three major advantages:

- 1. Share and bond holders get stronger incentives monitoring their managers**
- 2. Banks immediately have larger capital reserves**
- 3. No more perverse incentives (privatizing profits; socializing losses)**

In the meanwhile ...

As the crisis goes on:

- **High unemployment weakens the trade unions and the left-wing political spectrum → room for supply-side “structural reforms” → lots of low-productive, precarious jobs**
- **Depression and austerity weaken the innovation and knowledge potential in Mediterranean countries**

Possible

consequences:

Growing divergence of standards of living and unemployment rates between North and South in the Eurozone

Risk: Growing anti-EU populism can damage the European project!