ECONOMIC POLICIES IN THE EUROPEAN UNION

Özlem Onaran
Professor of Workforce and Economic Development Policy

University of Greenwich
Political Economy Research Centre

Outline

- The nature of economic policies in the Economic and Monetary Union
- The ‘euro crisis’ : causes and policy response
- Alternatives

Introduction

- European integration: Customs union, free movement of labour and capital
- 1986 Single European Act includes financial liberalization
- European Monetary System (EMS) in 1980s and 90s:
  - Exchange rate Mechanism (ERM)
    - currencies allowed to move in 2% bands
  - + long-term vision of monetary integration
- 1992 EMS crises
- 1999 Euro -high point of economic integration?

Maastricht Treaty (1991)

Convergence criteria

- Exchange rates: within bands
- Inflation: avg(lowest 3) + 1.5%-point
- Interest rate: avg(lowest 3) + 2%-point
- Budget deficit: less than 3% GDP
- Government debt: less than 60% GDP
- No Central Bank financing of government debt

Stability and Growth pact (SGP, 1997)

- Balanced budget in medium term
- No more than 3% deficit unless growth less than –2%

Economic and Monetary Union (EMU) policy package

- Maastricht Treaty, Stability and Growth Pact
- Exchange rates are fixed
- No central fiscal policy
- Restrained national fiscal policy (SGP)
- monetary policy is inflation targeting (anti-inflationary), ECB independent
- No bail out clause
- Labour market flexibility

Keynesian criticisms of EMU

- Is monetary union in the absence of fiscal and political union a good idea to begin with?
  - Post-Keynesians (Arestis, Sawyer), Euro-memo (Huffschmied), H. Flassbeck
- fiscal straight jacket: despite recession states cannot intervene
- Economies are severely constrained in countering adverse shocks:
  - Wage (labour market) flexibility (internal devaluation) is the only adjustment mechanism
- Deflationary bias: the Current Account deficit countries have pressure to adjust
- European social policy is hardly existing
- No coordiation of wage policy: increasing imbalances + race to the bottom
- No plan B for crisis scenario
- no welfare (e.g. GDP pc) or social indicators (unemployment) included in convergence criteria
- Thus *nominal* rather than *real* convergence

EMU as a neo-liberal project

- Evident in the construct of the Stability and Growth Pact, limits on national budget deficits without any EMU fiscal policy
- ‘Independence’ of the ECB
- Liberalisation and competition
  - Competition policy as a founding feature of the EU
  - Limitations on State Aid
- Labour market flexibility: ‘flexicurity’
- The Treaty of Lisbon
- Link with the ‘new consensus in macroeconomics’

... EMU as a neo-liberal project

- Attack labour → rising inequality
- Financial deregulation
  - → allows for higher degree of trade imbalances
  - → financial bubbles, rising indebtedness
- European neoliberalism uses EU to incapacitate the nation states: SGP, balanced budget requirements, wage flexibility … -> Monetarism
  - Quite different from the USA, which uses ‘Keynesian’ elements more liberally

Nature of money

- The euro as money without a State
  - without political union
- Implications for operation of Central Bank

Convergence criteria

- The ‘convergence criteria’ from Maastricht Treaty focused on nominal convergence (inflation, interest rates) and budget deficits.
- Shortcomings include:
- Inflation but not inflationary conditions
- No convergence of business cycles
- No concern expressed over unemployment and differences between countries at time when exchange rates being locked
- Exchange rate based on its stability without mention of whether appropriate, sustainable or of the current account position

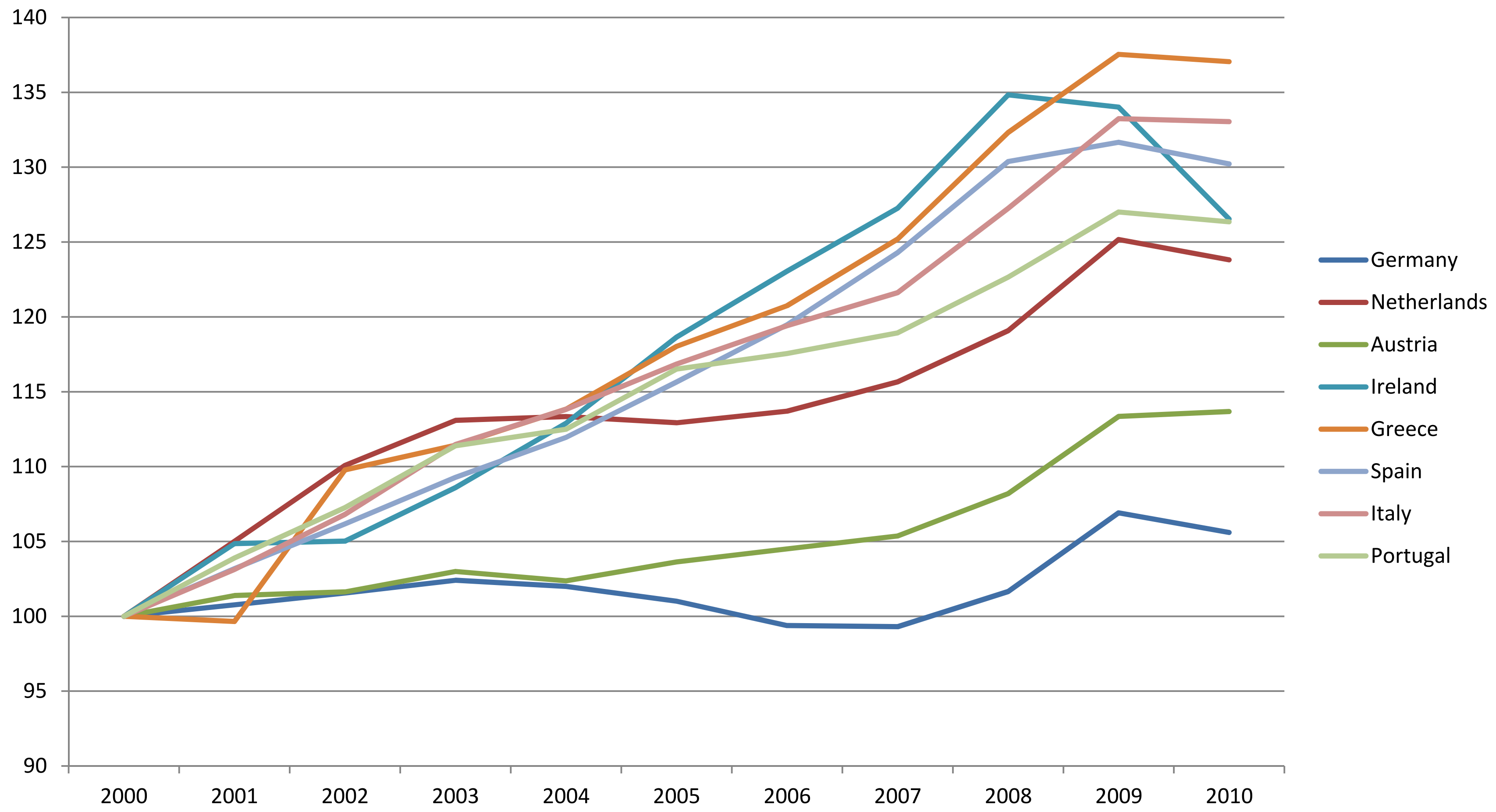
Not “Optimal Currency Area”

- Alternative adjustment mechanisms for loss of exchange rate: price flexibility, factor mobility, fiscal transfers
- Optimal currency area considerations largely ignored though some appeal to endogenous OCA
- Imbalances in current account positions present from the start
- Assumptions on similarity of economic institutions

The eurozone in the 2000s

- Relatively slow growth particularly in ‘core’ countries
  - Inflation rate generally just over 2 per cent
- Marked differences in inflation rates between countries -higher in the periphery
- Differences in evolution of unit labour costs
- Changes in competitiveness and in real exchange rates
- Current account imbalances and implications for capital flows and borrowing
- Differences in inflation = Differences in real rates of interest

Nominal unit labour cost (2000 = 100; AMECO)



One size fits all problems

- Stability and Growth Pact sought to impose common fiscal policy across countries
- Policy inconsistent and tends to be deflationary
- Monetary policy ‘one size’ by its nature
- Real interest rates lower in higher inflation countries, thereby boosting inflation
- Possible effects on credit boom and asset price inflation
- Interaction with current account deficits and surpluses

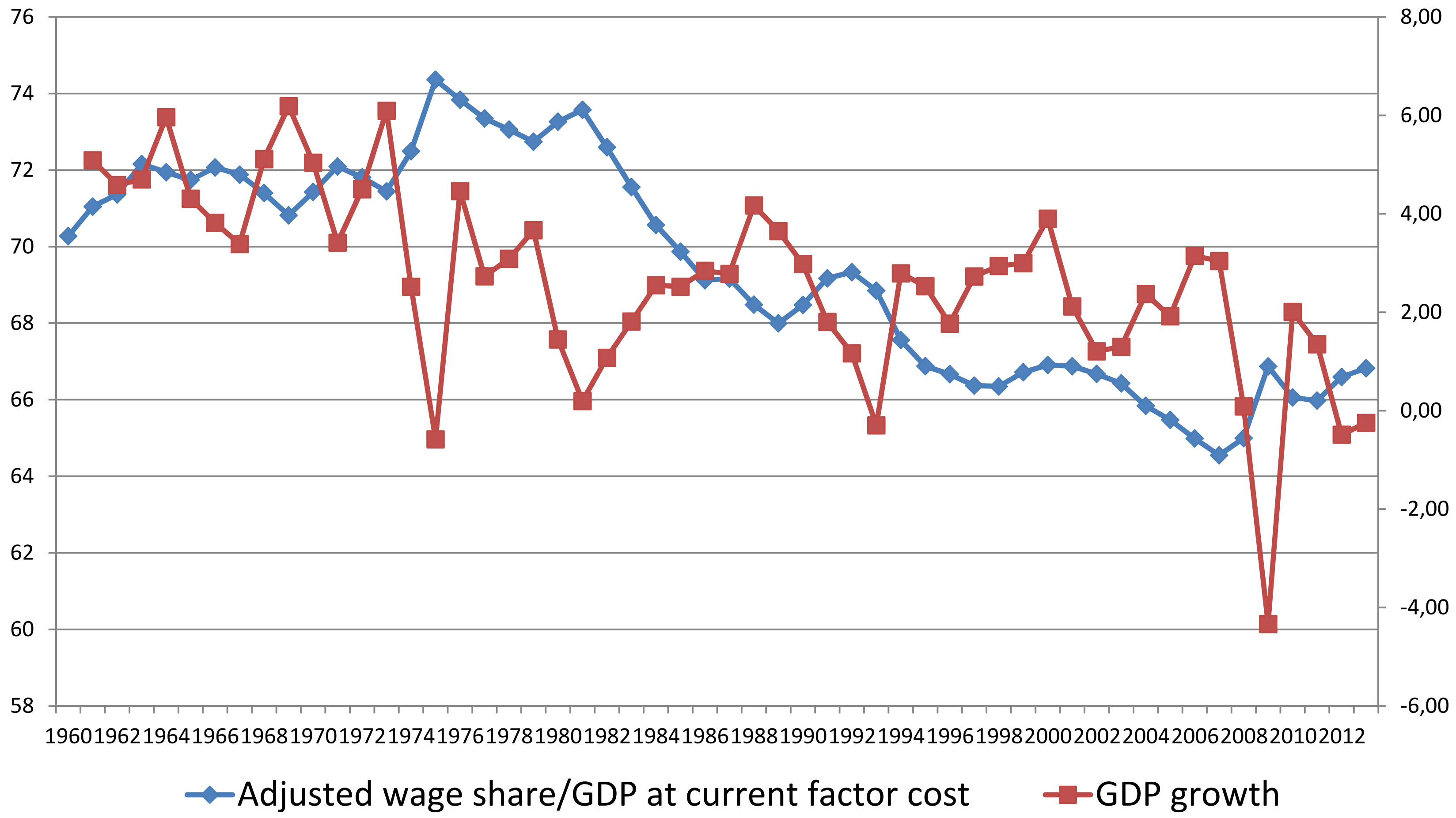
Missing targets

- Budget deficits: intended to be always less than 3 per cent of GDP and to be in balance on average
- Targets for budget deficits persistently missed by a range of countries

Falling wage share in the core and periphery of Europe

- Germany: wage moderation, low domestic demand, large current account surplus
- current account deficits, private or public debt in the periphery
  - Greece, Portugal, Spain, Ireland , in Eastern Europe in Hungary, Baltic States, Romania, and Bulgaria
  - unable to devalue+ lack of industrial policy, the only option for the periphery: wage moderation
  - But Germany: much more aggressive labor market policy
- fragile before the global crisis

Wage share vs. growth, EU15, 1960-2013



Source: Ameco

FT on Onaran and Galanis 2012

Capital gobbles labour's share, but victory is empty

The big picture

Steve Johnson looks at the wider negative implications of falling wages

In 1958, Walter Reuther, a powerful US union leader was taken on a tour of a newly automated Ford Motor plant. "Aren't you worried about how you're going to collect union dues from all these machines?" he was asked by a (no doubt smug) company manager.

"The thought that occurred to me," Mr Reuther replied, "was how are you going to sell cars to these machines?"

Fifty-five years on, such a debate may be even more pertinent. In the innocent days of 1958, wages accounted for half of America's gross domestic product.

labour's share of the pie than the US or UK.

Richard Lewis, head of global equities at Fidelity Worldwide Investment, who has studied this trend, believes it to be structural rather than cyclical, and therefore unlikely to reverse.

Mr Lewis says globalisation has "lowered the power of labour to bargain," resulting in de-unionisation and the "emasculation" of workers.

Simultaneously, companies have been able to optimise their tax regimes and can engage in both "financial expense" arbitrage (borrowing in the cheapest countries) and regulatory arbitrage.

Most importantly, however, he says globalisation and a move towards supranational corporate entities has made it possible for companies to consolidate their industries more effectively.

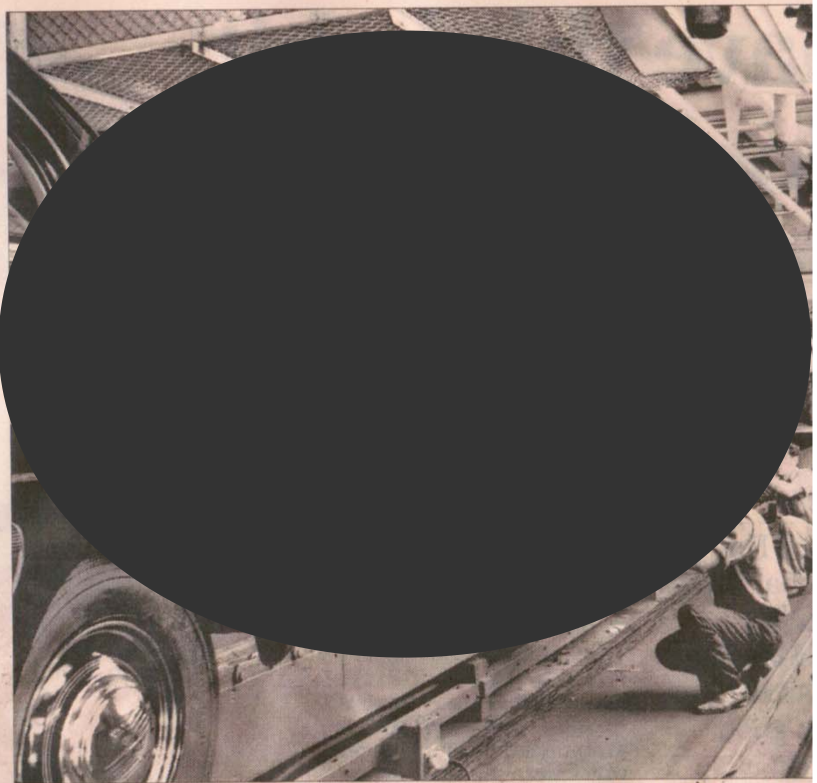
What all this means for the investment community is perhaps a little less clear-

labour will continue to be squeezed.

Frances Hudson, global thematic strategist at Standard Life Investments, believes this geographic divide opens the way for relative value trades that favour companies in countries that are becoming more competitive.

To complicate matters further, the academics found the global effect of a squeeze on labour was negative, as the heightened export competitiveness enjoyed by countries with weak wage growth simply reduced the competitiveness of its trading partners – a form of "beggar thy neighbour". A one percentage point fall in labour's share was found to reduce global GDP by 0.36 points.

With this in mind, Mr Greenberg believes we may have to start thinking about a "post-growth" world. "The revenue numbers of the S&P 500 are basically stagnant. Is that going to reverse any



In 1958, labour's share of economic output accounted for half of US GDP, but tha
increasing globalisation and technology, this has fallen to 42%

right all along, and that capitalism ultimately sows the seeds of its own destruction, "when there is no consumer demand and it all falls over".

Mr Greenberg paints a picture of a bleak future

with, barring a "mass uprising", "McJobs" increasingly the norm.

"One thing that does need to change is the idea of shareholder value being the only responsibility of a company," he says, alluding

to the 19th ce
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Mr Reuther
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What happens when wage share↓ simultaneously?

- Estimation results, 1960-2013, EU15 Onaran and Obst, 2015; G20 Onaran & Galanis 2012, ILO, Stockhammer, Onaran, Ederer 2009
- Domestic demand (consumption+investment) is wage-led
  - Large EU countries as well as some small EU countries are wage-led even in isolation
- If the wage share ↓ by 1% point in all 15 EU MS simultaneously:
- Gdp ↓ by 0.27% points in the EU15 (after multiplier effects)
- – →EU as a whole has a wage-led demand regime,
- – although some individual member states have a profit-led regime- e.g. if a small country, Austria or Ireland is the only one who decreases labor share, it can grow, but if every country does the same, they all contract
  - Intra European trade is high
- the limits of strategies of international competitiveness based on wage competition in a highly integrated global economy
- – Fallacy of composition

Europe and the world still grew despite declining wage share until the Great Recession. How?

- Potential crisis of aggregate demand deficiency
- Potentially a stagnation of demand and growth
- This was mainly circumvented by two distinct growth models
- Two versions of Wage-led demand regimes with wage moderation
- Two versions of the finance-dominated Neoliberal accumulation regime
- debt-driven growth and export-driven growth

	Debt-led growth	*Export-led growth*
Center	**US, UK, Australia**, New Zealand	**Germany, Japan, Netherlands**, Norway, Sweden, Austria, Canada, Finland, Belgium, Denmark
Periphery	**Spain, Greece, Turkey, Portugal**, South Africa, Ireland, Hungary, Czech Rep., Slovakia, Estonia, Cyprus, Slovenia	**China**, Korea

Fragile → a root cause of the Great Recession

The euro crisis

- The present difficulties of the EMU revealed by, rather than caused by, financial crisis
- Most of difficulties come from ‘design faults’ of EMU rather than ‘misbehaviour’ of member countries.
- Crisis is a result of rapid growth of *private* debt rather than *public* debt in most cases (exception: Greece)
- ... a result of imbalances within the Euro area
- Imbalances are a characteristic of neoliberal growth regimes.
  - rising inequality and 2 growth models: debt-led vs export-led
  - Wage suppression in Germany
  - Property bubbles amplified by capital flows in debt-led regimes

Euro crisis - preview

- Euro: building up of imbalances
- After 2008 risk premia increased for all assets
- ... Also for sovereign debt of some European countries
- 2010 Debt crisis in Greece
- Greece, Ireland, Portugal, Cyprus have to apply for funding from European Financial Stability Fund (EFSF)
- ECB: Hesitant /modest QE compared to USA and UK, reluctantly playing lender of last resort (LOLR) for private banks, does not play LOLR for governments, but finally decides to accept government bonds as securities
- Stringent austerity programs
  - But rising govt debt/GDP due to recession
  - No adjustment in surplus countries
- Six Pack and Fiscal Compact: ‘fiscal straightjacket’ of SGP further tightened
  - Debt breaks in national constitution
  - Countries can be taken to European Court of Justice if they breach deficit limits
- Weak recovery in USA, stagnation in UK, depression in Southern Europe
  - … because of dysfunctional economic policy regime

Anti-Keynesian fiscal policy during the crisis

- Neoliberal European integration has created half a European state, but fatally weakened nation states to intervene in crisis
- Crisis gravely amplified by a Neoliberal dysfunctional economic policy regime.
- Separation of fiscal and monetary space
- EU fiscal policy is non-existent
- National fiscal policies are constrained
  - Austerity in the South (‘internal devaluation’)
  - Deflationary bias
  - moderate counter-cyclical policy in Germany
  - Different national trajectories in the crisis

Crisis, Government debt, money and banks

- EMU has removed LOLR from nation states
  - Turned what would have been an exchange rate crisis into a sovereign debt crisis (similar to 'debt in foreign currency')
- Crisis has illustrated how closely linked the state and the (national) financial sectors are
- 1. A sovereign debt crisis is also a crisis of private banking sector
  - government bonds in banks' balance sheet
- 2. A banking crisis → public debt
- European neoliberalism wants to strangulate the nation states, but hasn't built a European one.

Changes in EU economic policy ☹

	SGP/Maastricht	*New regime (Fiscal Compact..)*
EU central fiscal policy	none	none
national fiscal policy	restrained	Substantially tightened (1/20 rule, constitutional debt brakes, European semester) Without debt restructuring ☹ =bailout of private banks
bail out clause	Ruled out	EFSF, ESM with conditionality
Monetary policy	Anti-inflation	Maintains inflation target Hesitant QE
Labour market		Part of conditionality; wage moderation/internal devaluation

Assessment: € barely survived

Euro at cross roads

- Grexit: Plan A of Schaeuble/Germany?
  - after fiscal discipline fiscal union
- IMF: More significant debt restructuring in Greece
  - Re-profiling vs some nominal write off
- Buiter : recapitalize Greek banks, but no more loans to the Greek government
- Alternative: A substantial write off of the Greek public debt; unsustainable, illegal, odious (Truth Committee on Public Debt)
  - Default, capital controls, nationalization/control of banks, parallel IOUs, electronic currency denominated in €
  - Timing: Limits of € reserves to finance imports rationing?
- Progressive Grexit?
  - independent monetary, fiscal , labour and industrial policy
  - Competitiveness?
    - Devaluation+inflation (if accompanied by default and hostile Eurozone)
    - not much gain in competitiveness
  - Limited € reserves in an import dependent country -recessionary
  - Uncertainty: Future of the €?
    - contagion to Portugal, Ireland, Spain, Italy in the medium run
  - currency wars?
  - Future of the Union?

Conclusion

- Imbalances are results of neoliberal growth models; interaction of financial liberalization and the polarization of income distribution.
- Policies to fix the broken accumulation regime have to address financial regulation (internal and external) as well as incomes/ wage policy.
- More egalitarian destribution of income is not luxury that can be taken care of, once the crisis has been resolved – distributional issues are at the very root of the crisis
  - Wage policy: wage growth is precondition of consumption growth without exploding debt
  - Wealth: equal distribution of wealth comes with less speculation

Equality led recovery in Europe in the age of globalization?

- mobilize all the tools of economic policy with an aim to achieve full employment with decent wages, equality for men and women, and ecological sustainability
- Synthesis of Kaleckian, Feminist, Ecological economics
- Equality-led development
  - Effects of wage-led recovery on growth and hence employment however is modest, albeit positive
- public investment in social and physical infrastructure
  - Physical infrastructure (housing, renewable energy. Transport): **green** jobs
  - Social infrastructure (education, health, child and social care): **Purple** jobs for both men and women
  - Care crisis and ecological crisis
- shorter working hours
- Globalization is not a barrier to these policies
- the limits of strategies of international competitiveness based on wage competition in a highly integrated global economy

A coordinated policy mix of wage-led recovery and public investment (Onaran 2014 L20)

- increase wage share by 1%-5% +public investment by 1% of GDP in each country in the next 5 years in G20
- →3.9-5.84% more growth in G20
- Only wage-led recovery: 1.96% more growth in G20
- Only public investment : 1.94-3.88% higher growth in G20

An alternative economic policy for the EU

- Fiscal policy
- decrease inequality
  - Coordinated progressive income and wealth taxes, higher corporate tax rates, inheritance tax
  - UK1974-79: the top income tax rate was 83% above £90,500 in today's prices !
- Effective taxation of the financial sector
- Closing of tax loop holes, offshore financial centres
- Public finance and debt audit/restructuring
  - coordinated at the EU level
  - European Debt Conference to write-off substantial parts of public debt
  - ≈Taxation of wealth and bank balance sheets

…An alternative economic policy for the EU

- Monetary policy
  - Turn ECB into a real CB
- Aim: high and sustainable levels of employment and economic growth, in addition to price stability
- Higher inflation target in Euro-land
- The ECB should undertake explicitly the role of lender of last resort for both the governments and banks
- responsible for the stability of the EMU financial system
- The ECB must be made accountable to the European Parliament;
  - should be ready to take instructions from European bodies

...An alternative economic policy for the EU

- Financial sector – introduce speed bumps for financial flows
  - private financial flows have fuelled imbalances
  - Regulating the shadow banking system
  - FTT: fiscal income
  - Not-for-profit financial sector
  - Democratic control (participation, public/social ownership)

...An alternative economic policy for the EU

- Systemic public financial flows across Europe – A European welfare state
  - Large EU budget
  - progressive EU taxes
  - Eurobonds
  - The enhancement of the functions of the European Investment Bank (EIB), or a similar institution, to ensure high rates of capital formation across the EMU
  - Pay-as-you-go pension scheme
  - European unemployment benefit system to redistribute from low to high unemployment regions.
  - coordinated minimum wage (Schulten and Watt 2011)

Wage Policy Implications

- A vicious circle of wage cuts lead to lower growth and fewer jobs
- ↑wage share : egalitarian; does not harm growth potential

→ importance of wage/macro policy coordination

- Avoid beggar thy neighbour policies
- Focus on wage flexibility is misplaced
  - Does not guarantee full employment
  - Unable to guarantee a fair and stable distribution of income
  - Unable to avoid international imbalances
- Productivity-oriented wage policy to stabilize effective demand
  - Initial correction to reflect the productivity gains of the past three decades
- Coordination of wage bargaining systems to prevent a race to the bottom
- wage policy has to take into account current account positions

Labour market institutions

- Increase the bargaining power of labour
  - Reregulate the labour market
  - union legislation,
  - increasing the coverage of collective bargaining,
  - establishing sufficiently high minimum wages,
  - Close gender wage gaps
  - regulating high/executive pay
- need social partnership and a greater say of unions in other policy areas (social and monetary policy)

Wage coordination

- Stockhammer and Onaran 2012
- Aim:
  - ensure that living standards of the working class are growing
  - Prevent excessive inflation
  - Prevent/counteract imbalances
- $w_j = x_j + p^T + a(ULC_{EU} – ULC_j)$
  - w..wage growth, x..productivity growth, p^T..inflation target, ULC..unit labour costs,
  - Subscripts EU and country j
  - p^T would have to be set such as to avoid deflation in all countries, while allowing rebalancing
  - productivity growth to be stimulated by an investment plan

How can the €-zone re-balance?

Rebalancing: cost differences, debt ratio

$BD = S_F + S_{HH} - NX$

- One sector's /country's asset is another sector's /country's liability

How much rebalancing is necessary? (Stockhammer and Sotiropoulos 2012)

  - ULC 25-30%
  - German nominal wage growth has to be 2.5%-pts. above mediterranean wage growth for 10 years!

- 1 deflationary adjustment in deficit countris (internal devaluation)
  - Big contraction in the periphery to bring down GDP and ULC and CA-deficit
  - rebalancing requires 23-47% decline in GDP in GIIPS
  - But: *that means rising debt ratios!*
- 2 debt restructuring
- 3 inflationary adjustment in surplus countries
  - Expansion and substantially higher wage growth in Germany

- Wage inflation?
- ECB needs a pay rise!
- a 1%-point rise in the wage share leads to a 1.4% rise in the prices in the EU15 (Onaran and Obst 2015).
- a nominal wage increase of 3.5% in the EU15 (2.7% in Ireland) (assuming 0.7% rise in productivity along with historical averages)
- The risk now is deflation not inflation

- appendix

Budget Deficit/GDP

	2006	2007	2008	2009	2010
Germany	-1.64	0.19	0.04	-3.30	-4.95
France	-2.32	-2.73	-3.34	-7.58	-7.98
United Kingdom	-2.73	-2.79	-4.89	-11.41	-11.84
Ireland	2.96	0.14	-7.26	-14.28	-32.30
Greece	-3.84	-5.37	-7.67	-13.52	-9.37
Spain	2.02	1.91	-4.06	-11.19	-9.80
Portugal	-3.94	-2.65	-2.90	-9.43	-8.53

Public debt/GDP and change in debt in 2011-2007

	EU 27	UK	Germany	France	Belgium	Italy
2007	59.0	44.5	64.9	63.9	84.2	103.6
2008	62.3	54.4	66.3	67.7	89.6	106.3
2009	74.4	69.6	73.5	78.3	96.2	116.1
2010	80.2	80.0	83.2	81.7	96.8	119.0
2011	82.3	84.2	82.4	84.7	97.0	120.3
2011-2007	23.4	39.7	17.4	20.7	12.8	16.7

	Ireland	Greece	Spain	Portugal	Latvia	Lithuania
2007	25.0	105.4	36.1	68.3	9.0	16.9
2008	44.4	110.7	39.8	71.6	19.7	15.6
2009	65.6	127.1	53.3	83.0	36.7	29.5
2010	96.2	142.8	60.1	93.0	44.7	38.2
2011	112.0	157.7	68.1	101.7	48.2	40.7
2011-2007	87.0	52.3	32.0	33.5	39.2	23.8

Ameco, 2011 May forecast

Average annual % change (compound) in real wages and productivity, 1991-2007

	France	Germany	United Kingdom	Greece	Ireland	Portugal	Spain
Real wages	1.09	0.48	1.91	1.56	1.98	2.00	0.19
Productivity	1.23	1.35	2.08	1.97	2.88	1.70	0.60

real wages even decline in Germany and Spain during the 2000s

Source: OECD National Accounts Real wages=Labour compensation/number of employees/private consumption price deflator Productivity=GDP/number of employed persons

Increase in household debt (% of GDP)

Increase in HH debt (in % GDP) 2000/08			
Germany	-11.34	USA	26
Netherlands	32.83	United Kingdom	28.13
Austria	7.91		
		Ireland	62.72
		Greece	35.46
France	15.75	Spain	33.84
		Portugal	27.38
Source: Eurostat, except USA: FoF			

Current account (% GDP)

Current account (% GDP), avg. 2000-07

Germany	3.8	Greece	-8.5
Austria	1.7	Portugal	-8.9
Netherlands	5.6	Spain	-5.8
		Italy	-1.3
		Ireland	-2.1

Europe's Lehmann moment

- "on 6-7 May tensions in the sovereign debt markets of some euro area countries spread to other segments of the financial markets. Volatility in the financial markets increased sharply and liquidity conditions deteriorated significantly not only in sovereign bond markets, but also and to a critical degree in the money markets. Transactions within the interbank market declined rapidly and uncertainty among banks about counterparties' creditworthiness increased." (ECB Monthly Bulletin June 2010, 41)
- **"heightened concerns about the probability of default of some European financial institutions. Indeed, the probability of a simultaneous default of two or more euro area large and complex banking groups, (...) rose sharply on 7 May, reaching values higher than in the aftermath of the collapse of Lehman Brothers."** ECB Monthly Bulletin June 2010, 38-39

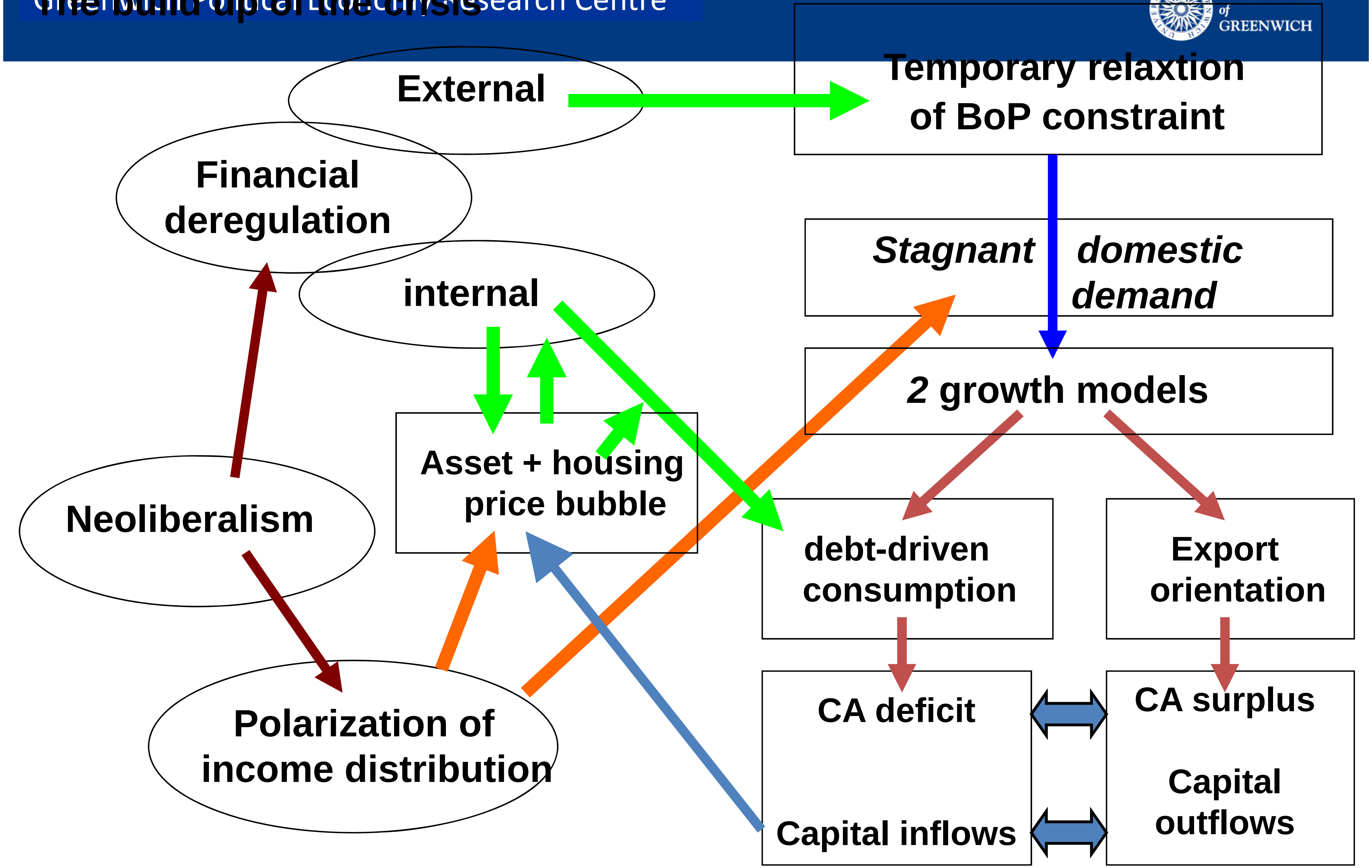
- *Sovereign debt crisis = (private) banking crisis*

Budget deficits

Budget deficit (% of GDP) 2007			
Germany	0.2	Ireland	0.1
Netherlands	0.2	Greece	-5.4
Austria	-0.5	Spain	1.9
		Italy	-1.5
Euro (12)	-0.6	Portugal	-2.7

	Public debt	Public debt	Unemployment		Real wages
	2007	***2012***	***2007***	***2012***	***2012/2007***
Greece	117.2	181.3	8.3	23.6	-9.3
Ireland	28.7	123.2	4.6	14.8	+9
Portugal	75.5	125.6	8.0	15.5	+0.1

The build up of the crisis



Changes in EU economic policy?

- Fiscal policy: further tightening ☹
- Monetary policy: half-hearted
  - Initially made things worse by putting pressure on Greece ☹
  - Then bent its rules to back Greek gov‘t bonds ☺
  - No indication that ECB will change inflation target ☹
- No bail out clause: effectively suspended (EFSF) ☺
  - But like standard IMF austerity program ☹
  - Without debt restructuring ☹ =bailout of private banks
  - Deepening of the sovereign debt crisis once again in June-August 2011
  - 2nd Greece bailout; stabilize debt at 150% of GDP!
  - Private creditor participation, voluntary, not compulsory, helped further bailout of private banks
  - Contagion to Spain (private banks) and further Italy (despite primary surplus; 7 years average debt maturity)
  - +risk perceptions & spreads↑ for France in 2011 due to EFSF comittments (if guarantees were triggered, its public debt could ↑ 100%)
- Wage policy: pressure on wages, no indication of coordination ☹
- Assessment: barely survived