

# Exports, debt and austerity. Comments on the dysfunctional economic policy regime in Europe

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# outline

- Global financial crisis began in the USA,
- but only turned into stagnation/depression in North/South Europe
- Export-driven and debt-driven growth
  - Both are unstable growth models
- => imbalances
- European economics policy: 'internal devaluation' = austerity + wage cuts, and half-hearted QE
- has worsened the crisis
- Radical changes in economic policy regime

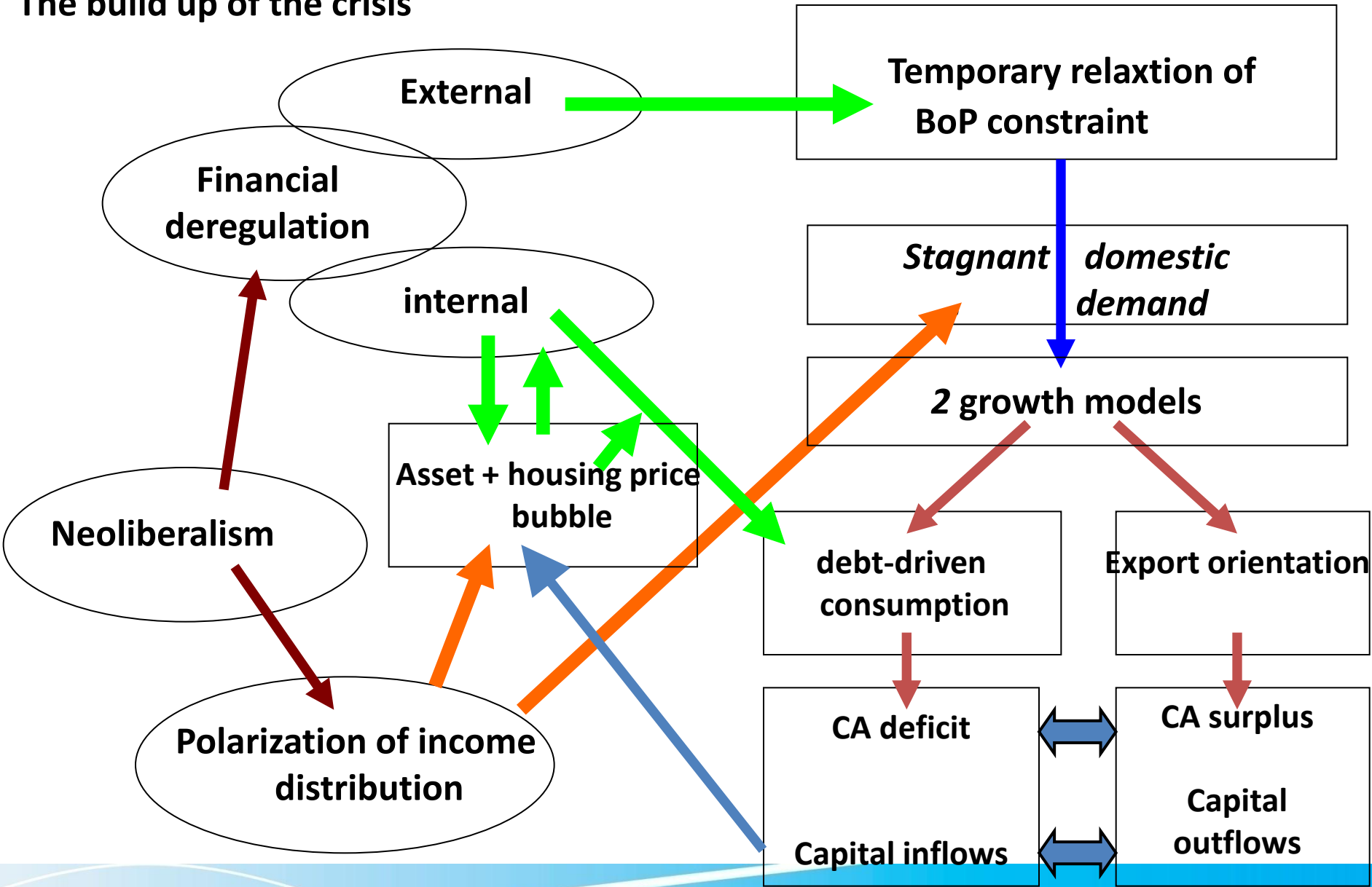
# ***Increase in household debt (% of GDP)***

<b>Increase in HH debt (in % GDP) 2000-08</b>			
Germany	-11.3	USA	26
Netherlands	32.8	UK	28.1
Austria	7.9		
		Ireland	62.7
		Greece	35.5
France	15.8	Spain	33.8
		Portugal	27.4
Source: Eurostat; USA: FoF			

# International imbalances at the outset of the crisis

current account (%GDP) 2007			
Germany	7,9	United Kingdom	-2,7
Austria	3,6	United States	-5,2
Netherlands	8,7		
		Greece	-14,5
Japan	4,8	Ireland	-5,3
China	5,2	Spain	-10
		Portugal	-9,4
		Italy	-2,4

# The build up of the crisis



building up of imbalances (in Europe: German wage suppression + financial bubbles in the South)

Crisis 2008-

**Debt-led economies**

Recession + stagnation due to debt overhang

**Export-led economies**

Short sharp recession with strong recovery

**USA**

Some counter-cyclical fiscal policy  
QE → interest rates on govt bonds low

**Europe**

Fiscal straightjacket  
Hesitant QE: ECB does not play lender of last resort (LOLR) for govts

**Other** export-led economies (Japan, China)

**South**

GIIPS

**North**

Germany...

weak recovery

Debt deflation  
Sovereign debt crisis

stagnation/  
weak recovery

# The dysfunctional economic policy regime of the Euro area

# Changes in EU economic policy?

	<i>SGP/Maastricht</i>	<i>New regime (Fiscal Compact..)</i>
<b>EU central fiscal policy</b>	none	none
<b>national fiscal policy</b>	restrained	Substantially tightened (1/20 rule, constitutional debt brakes, European semester)
<b>bail out clause</b>	Ruled out	EFSF, EMF with conditionality
<b>Monetary policy</b>	Anti-inflation	Maintains inflation target Hesitant QE
<b>Labour market</b>		Deregulation part of conditionality
<b>Financial market</b>	liberalised	liberalised



# A neoliberal policy regime?

	<i>SGP/Maastricht</i>	<i>Neoliberalism</i>
<b>fiscal policy (FP)</b>	No EU FP Restrained national FP	'Sound fiscal policy' Fiscal (tax) competition is desirable
<b>Monetary policy</b>	Anti-inflation	Price stability + independence of monetary policy
<b>Financial market</b>	liberalised	Deregulated financial market are efficient
<b>Labour market</b>	Deregulation as part of conditionality	Unemployment due to wage rigidities

# Keynesian criticisms

- Is monetary union a good idea to begin with?
- Post-Keynesians (Arestis, Sawyer), Euro-memo (Huffschiemied), H. Flassbeck
- Relies exclusively on labour market flexibility in case of asymmetric shocks
- Deflationary bias: the CA deficit countries have pressure to adjust
- No coordination of wage policy: increasing imbalances + race to the bottom
- No plan B for crisis scenario

# Economic Effects of austerity and internal devaluation

# The costs of 'internal devaluation'

## Stockhammer & Sotiropoulos (2014)

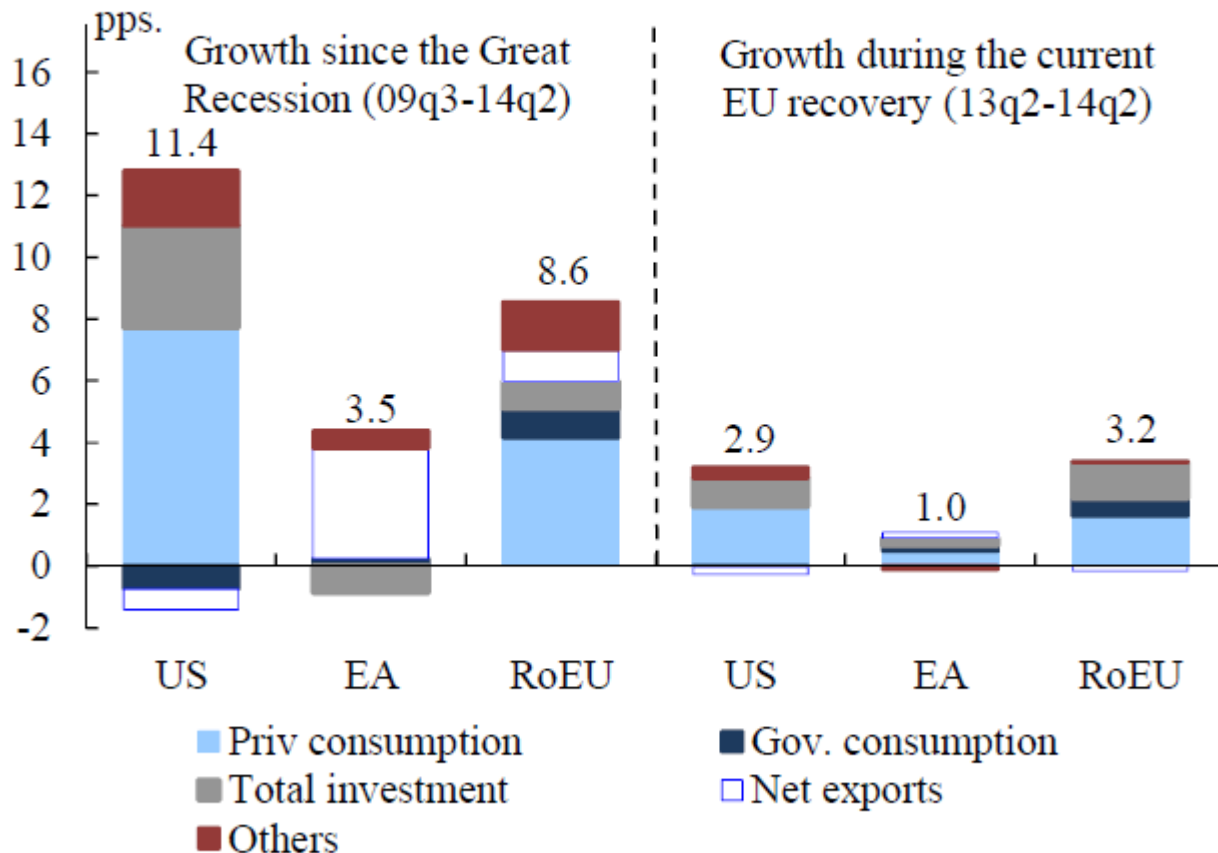
- GIIPS had average NX of -8.4% (GDP) in 2007. given standard macro relations, what is the output decline required to balance NX?
- Estimate panel of EU12 countries (1999-2011)
- NX-equation:  $NX = f(Y, ULC)$
- Phillips curve:  $ULC = f(U, PM)$
- Okun's Law:  $\Delta U = f(\Delta Y)$
- Finding: need -23% (recession sample) to -47% (full sample) GDP

# Gap actual to trend growth 2014

	<b>Trend growth 1998-2008</b>	<b>Actual 2008-14</b>	<b>Gap 2014</b>
<b>European Union (28)</b>	<b>2.3%</b>	<b>0.2%</b>	<b>14.6%</b>
<b>Euro area (18)</b>	<b>2.1%</b>	<b>-1.5%</b>	<b>14.7%</b>
<b>Germany</b>	<b>1.6%</b>	<b>3.5%</b>	<b>6.3%</b>
<b>France</b>	<b>2.0%</b>	<b>2.0%</b>	<b>10.9%</b>
<b>Italy</b>	<b>1.2%</b>	<b>-7.7%</b>	<b>15.3%</b>
<b>Spain</b>	<b>3.6%</b>	<b>-6.2%</b>	<b>29.6%</b>
<b>Ireland</b>	<b>5.1%</b>	<b>0.2%</b>	<b>34.8%</b>
<b>Greece</b>	<b>3.5%</b>	<b>-25.2%</b>	<b>48.2%</b>
<b>Cyprus</b>	<b>4.1%</b>	<b>-10.5%</b>	<b>37.9%</b>

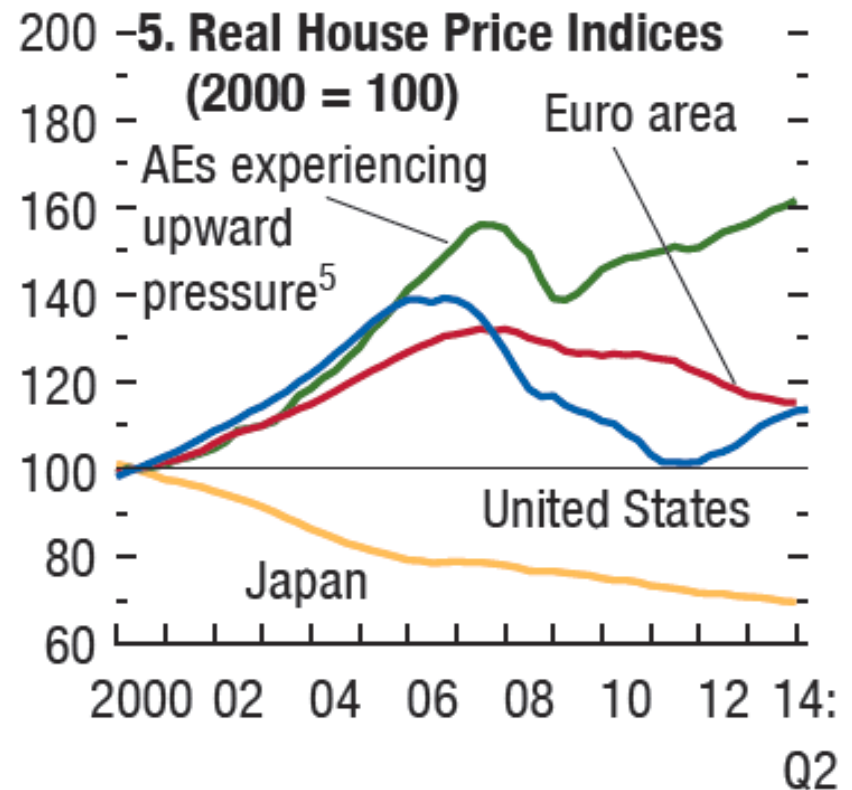
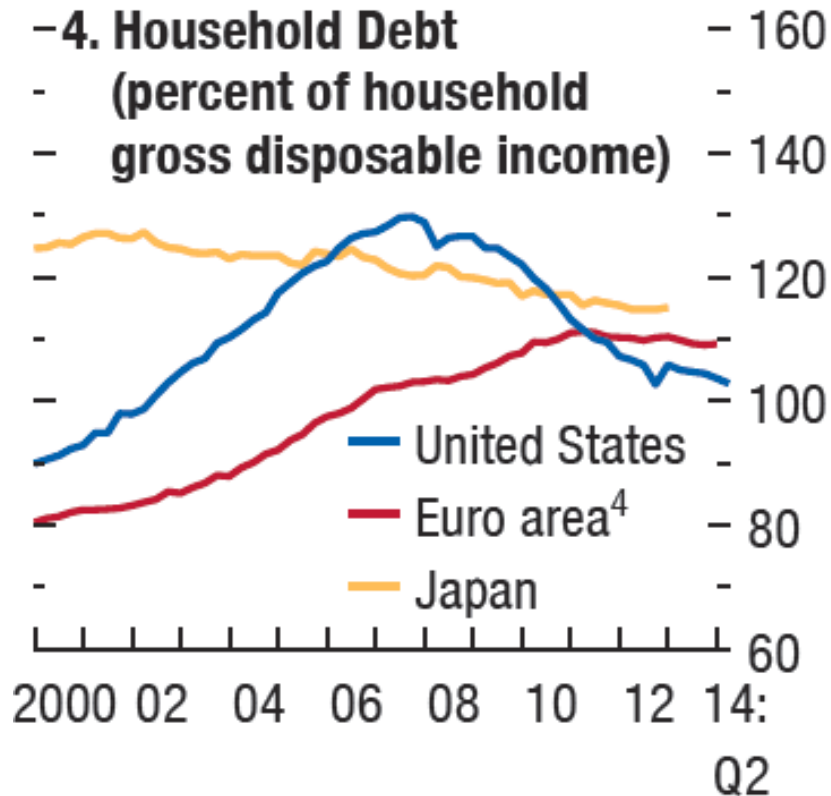
# Growth contributions after Great Recession

Graph I.6: Post-crisis GDP growth, contributions, in the US, euro area and rest of the EU

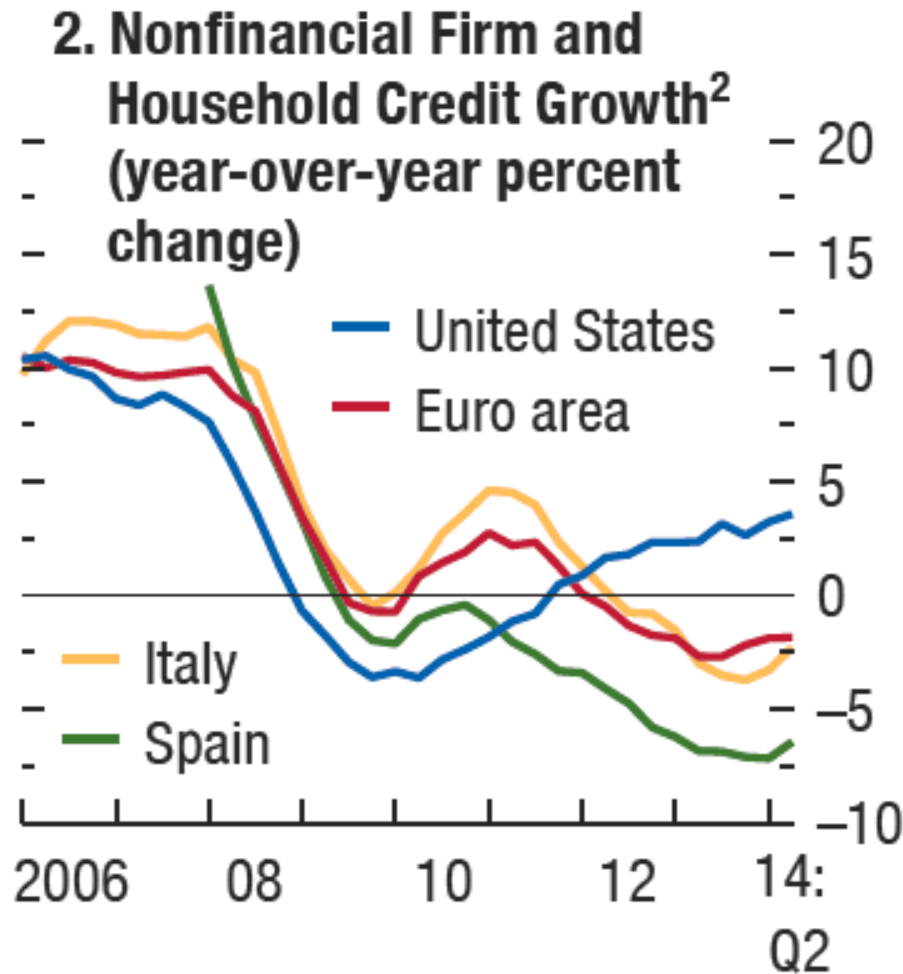


Figures on top of the bars indicate total GDP growth (in %).

# Declining house prices, but high HH debt

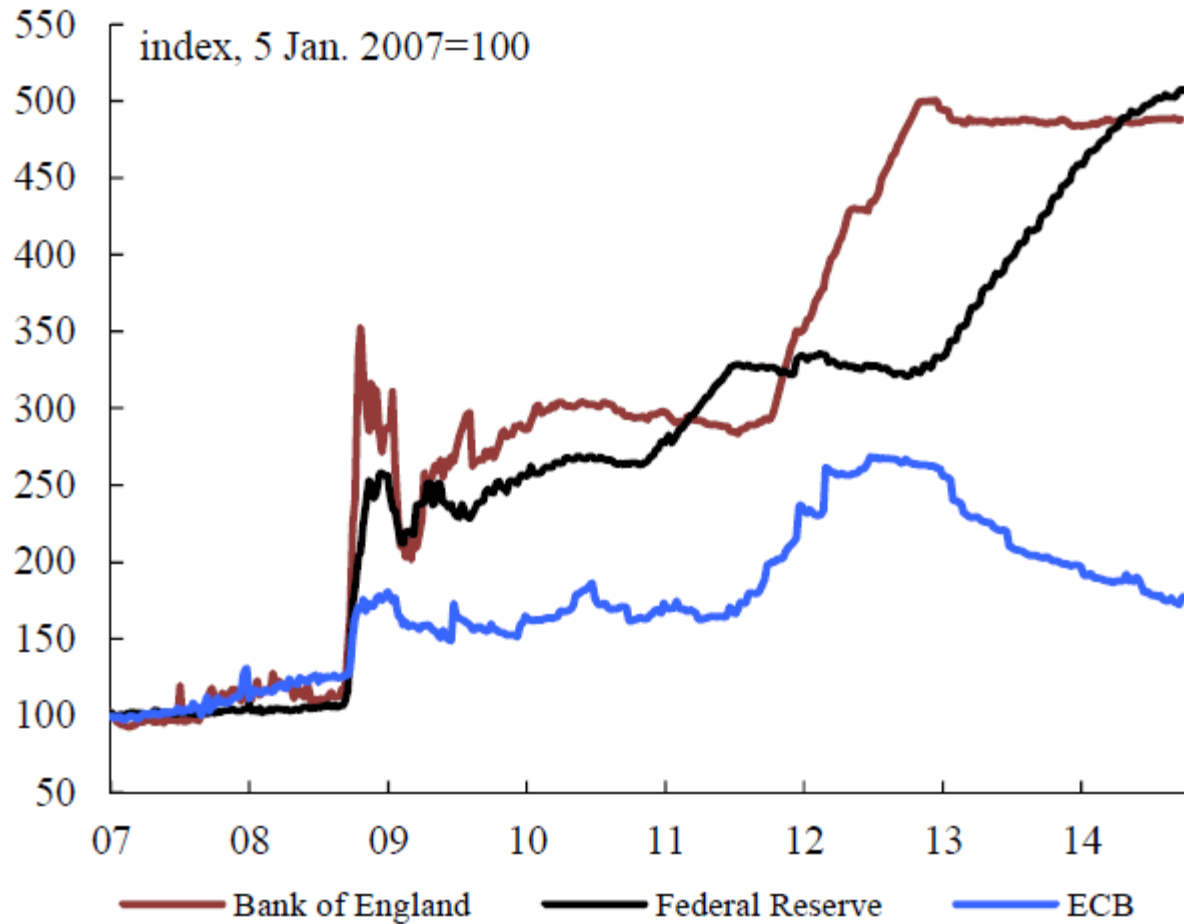


# NFC and HH credit growth





*Graph I.10: Central bank balance sheets, euro area, UK and US*

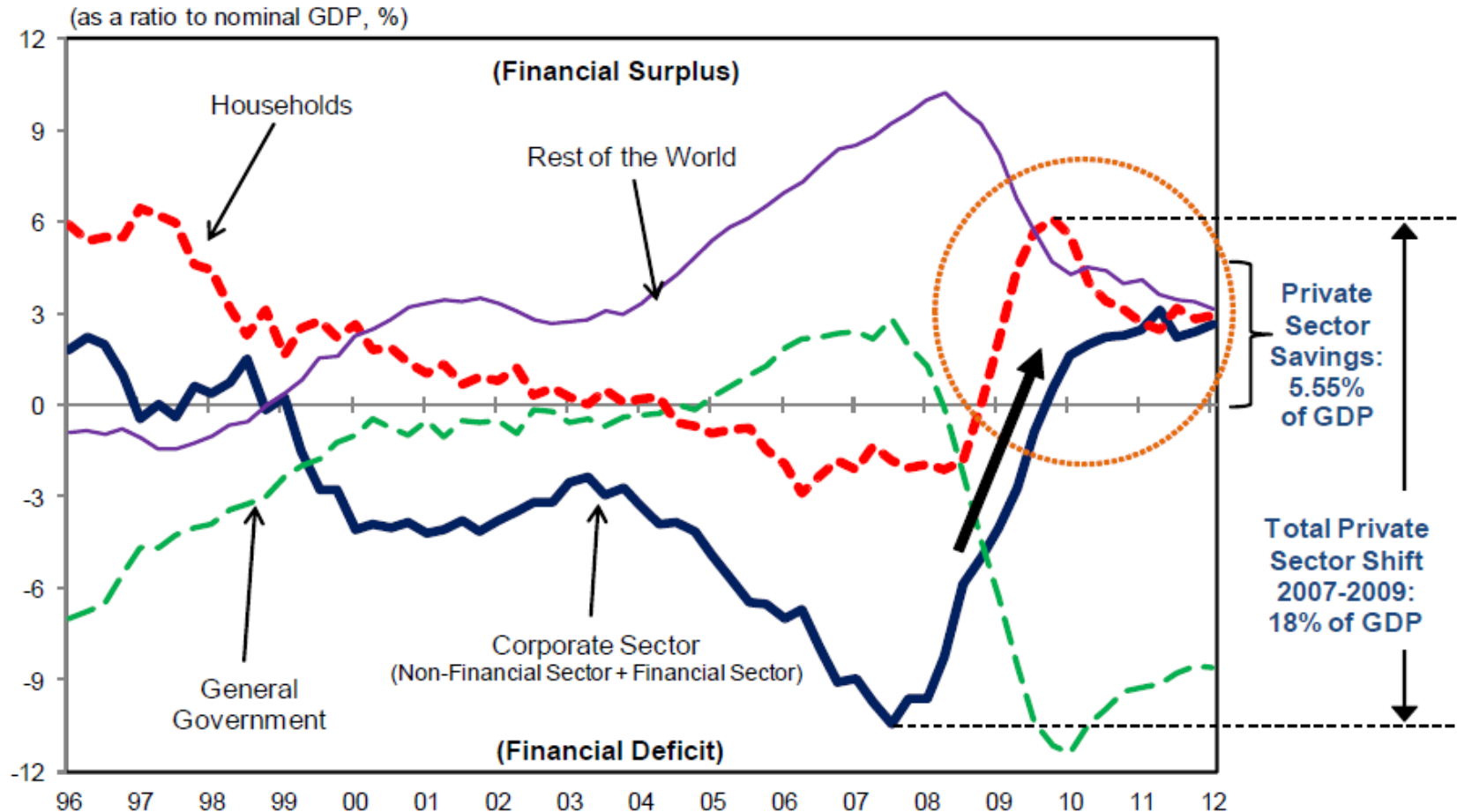


# Money, states and monetary policy

- Money is a private-public partnerships
  - Created by (private) commercial banks
  - Guaranteed by (public) CB and govt
- CBs are LOLR for private as well as public sector
  - Most CB created to guarantee state financing
- EMU has divorced monetary from fiscal space
- ECB is playing LOLR for private sector but reluctantly for public sector
  - EMU has removed LOLR from nation states
- EMU has turned what would have been an exchange rate crisis into a sovereign debt crisis (similar to 'debt in foreign currency')
- QE does not work the same way as in USA, UK, Japan, where monetary and fiscal space coincide
  - US banks, HH buy US gov't bonds
  - Spanish banks, HH can buy Spanish or German gov't bonds

# Exhibit 4. Spain in Balance Sheet Recession: Spanish Private Sector Increased Savings Significantly after the Bubble

## Financial Surplus or Deficit by Sector



Note: All entries are four-quarter moving averages. For the latest figures, four-quarter averages ending with 1Q'12 are used.  
Source: Banco de España

# Thinking about strategies in the Euro area

		<i>How to deal with demand</i>	
		Austerity + internal devaluation	Growth and inflation
		<i>Adjustment in trade deficit countries deflationary</i>	<i>Adjustment in trade surplus countries</i>
<i>How to deal with debt</i>	Do nothing		
	Bankruptcy		
	Restructuring / Bail in		
	Bail out		
	Bail out + QE		

# Conclusion. A Keynesian strategy

- Inflationary adjustment
  - higher wages in surplus countries (Germany!)
  - To erode debt burden
- need wage growth to stabilise demand (wage-led growth)
  - Wage coordination and a European System of minimum wages (Schulten and Watt 2011)
- Monetary policy
  - Higher inflation target in Euro area
  - More to underwrite public debt of MS
- Restructuring the financial sector
  - Emulate national financial spaces (FTT, ASR, Macroprudential policy)
  - Need for development/semi-public banks (EIB?)
- If the Euro is to survive in the longer term
  - Has to be consistent with expansionary fiscal policy for countries in crisis
  - Will have to build fiscal capacities at EU level
    - European welfare system = automatic redistribution
    - Taxation of wealth and corporations