

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

Levy Institute Conference, *Europe at the Crossroads: A Union of Austerity or Growth Convergence?*, Athens, Nov. 2014

Engelbert Stockhammer
Kingston University, UK

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)

Increase in HH debt (in % GDP) 2000-08			
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

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

A neoliberal policy regime?

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

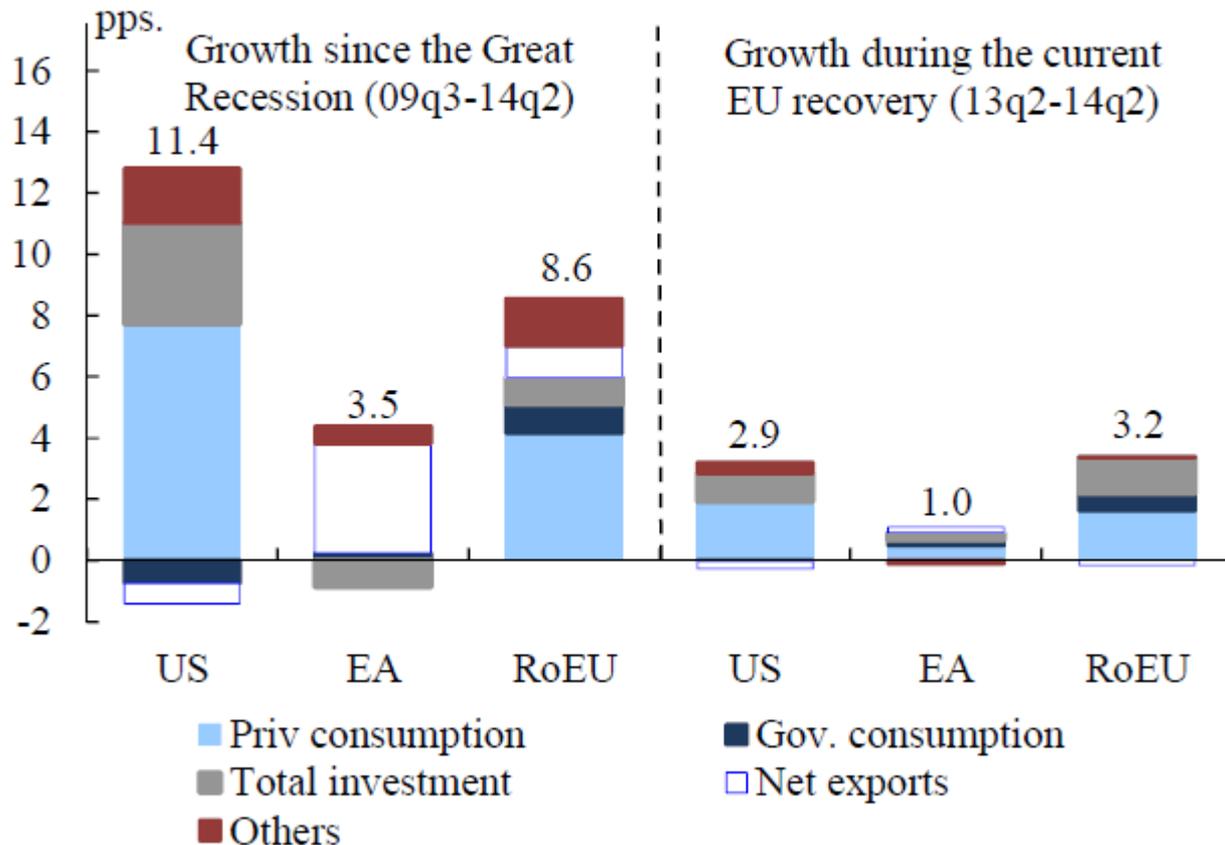
- GIIPS had average NX of -8.4% (GDP) in 2007. given standard macro relations, what is the output decline required to balance NX?
- Estimate panel of EU12 countries (1999-2011)
- NX-equation: $NX = f(Y, ULC)$
- Phillips curve: $ULC = f(U, PM)$
- Okun's Law: $\Delta U = f(\Delta Y)$
- Finding: need -23%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

Gap actual to trend growth 2014

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

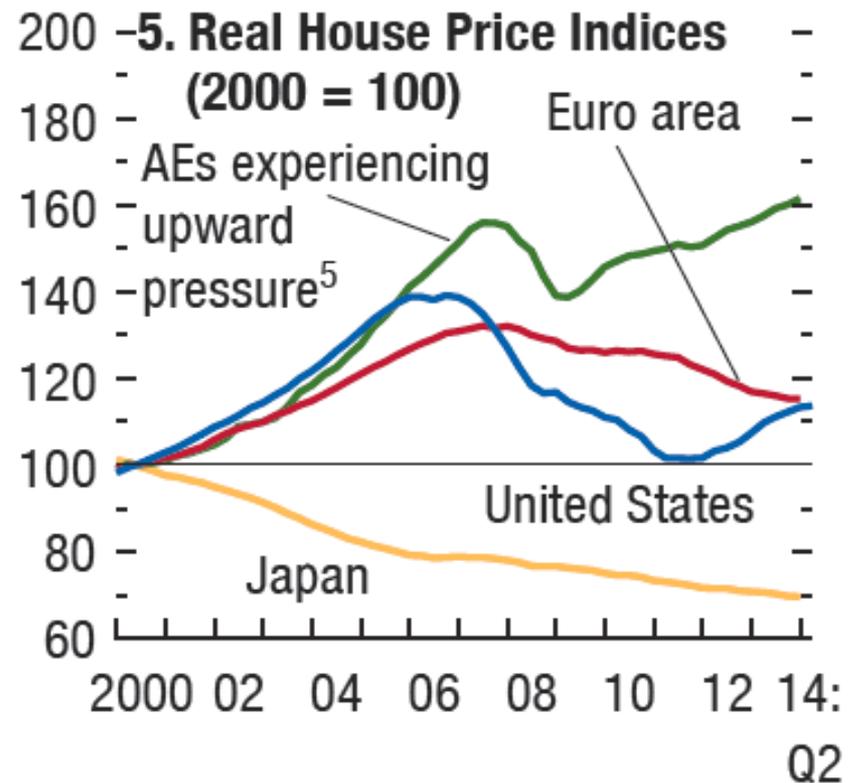
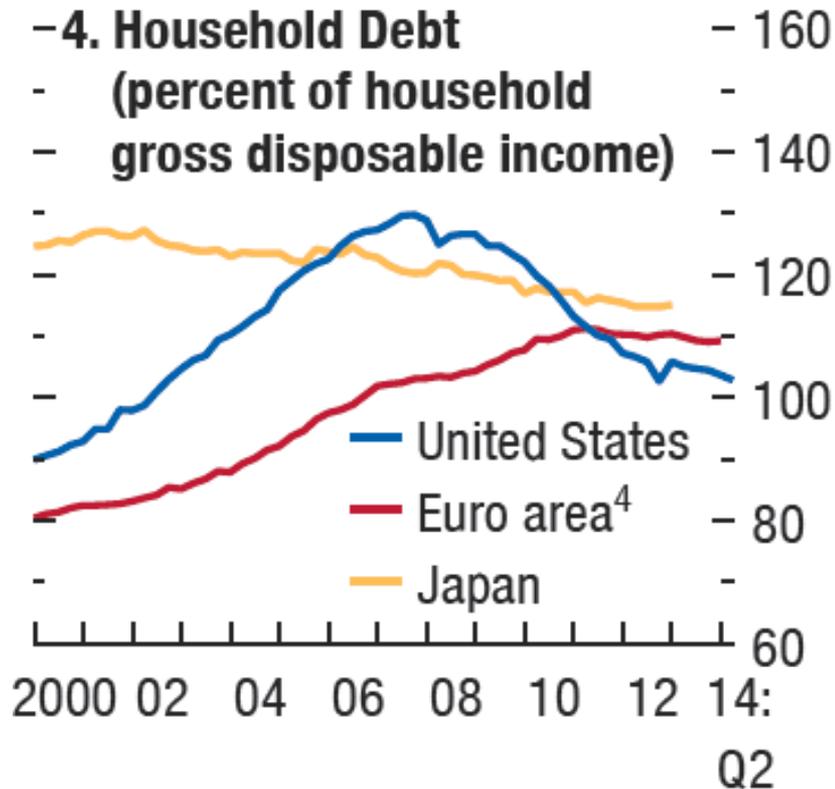
Growth contributions after Great Recession

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

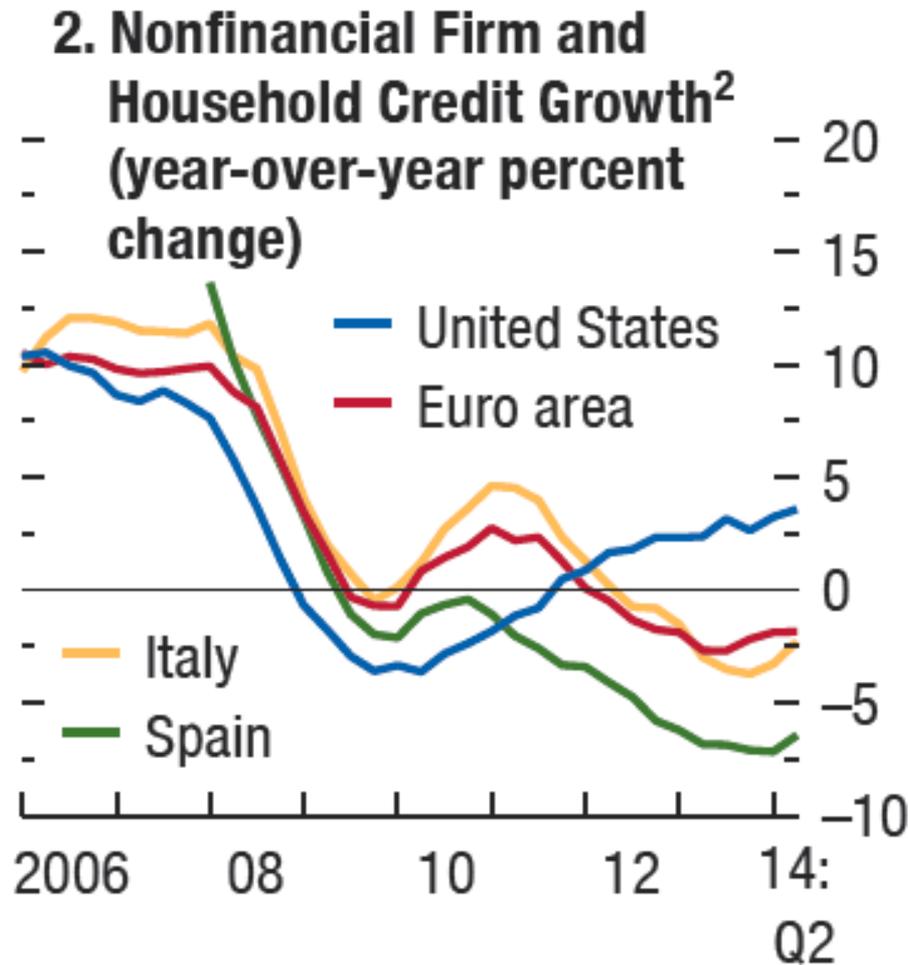


Figures on top of the bars indicate total GDP growth (in %).

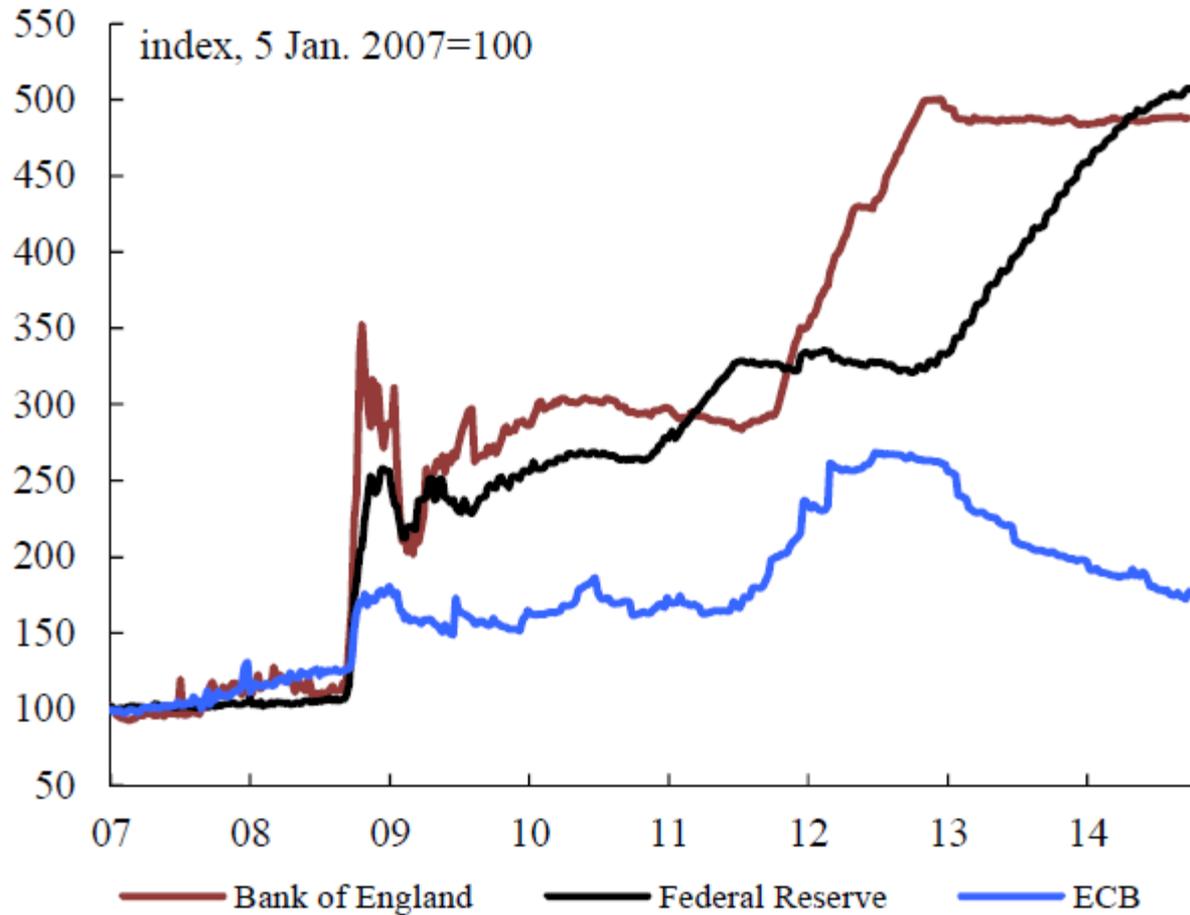
Declining house prices, but high HH debt



NFC and HH credit growth



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

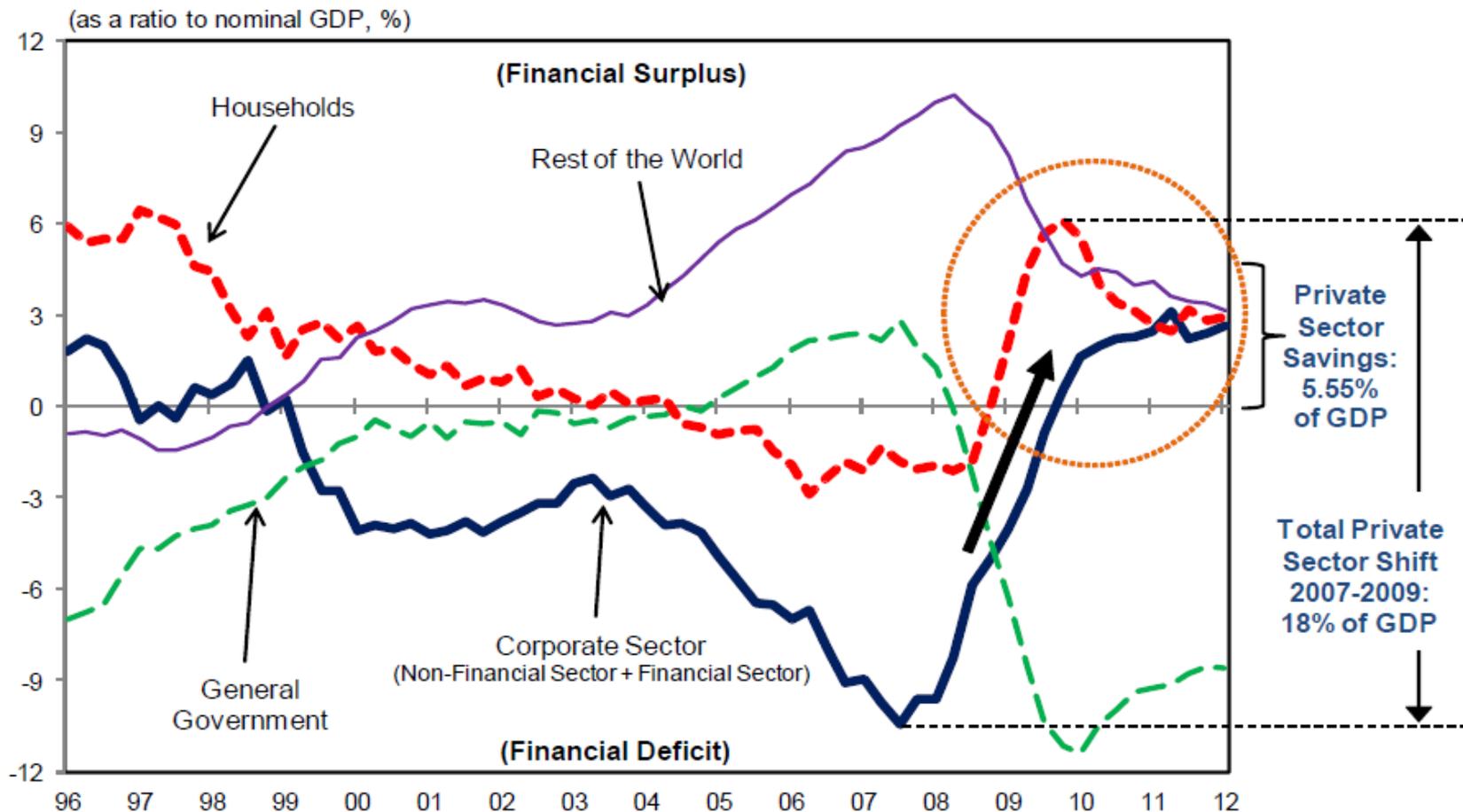


Money, states and monetary policy

- 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