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The crisis of finance-dominated capitalism in the Euro area, deficiencies in the economic policy architecture and deflationary stagnation policies

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1. **Introduction**
2. **Finance-dominated capitalism in the Euro area: rising inequality and macroeconomic imbalances**
3. **Euro crises and deflationary stagnation policies**
4. **Alternatives to deflationary stagnation policies**
5. **Conclusions**

- **Euro crisis as the most recent episode of the crisis of finance-dominated capitalism (FDC)**
- Elements of FDC

  1. De-regulation of national and international goods, labour and financial markets, in particular

  2. Re-distribution of income at the expense of (low) wages

  3. Rising imbalances of current accounts at the global level and at regional, i.e. European levels

- **Crisis is threatening the further existence of the euro for two reasons:**

  1. Explicit guarantee of public debt of member countries by the ECB is excluded from the treaties and regulations of the EU

➔ Public debt is debt in a common currency

  2. Stable and sustainable transfers among member countries have also been ruled out by the treaties

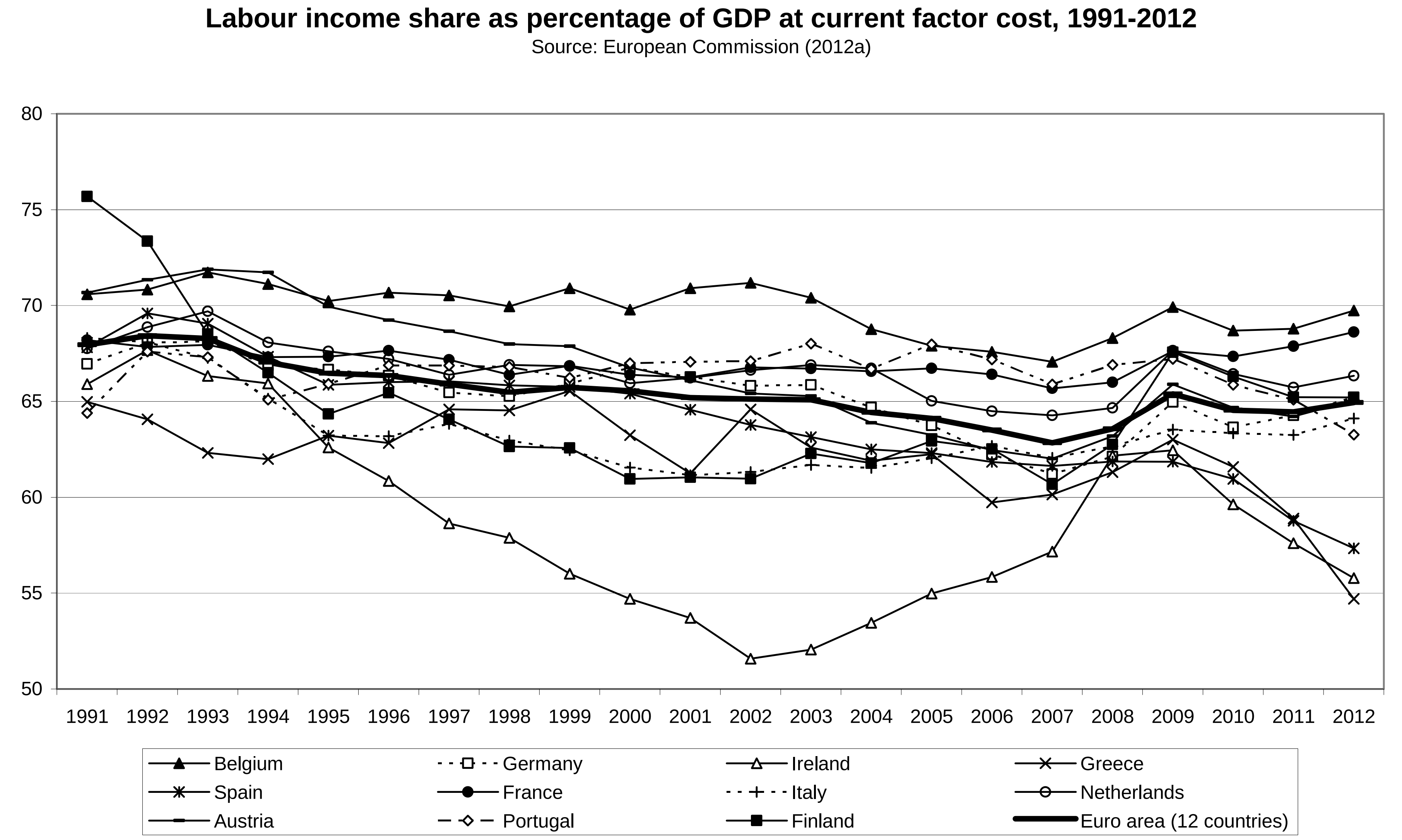
  + No efficient mechanisms to prevent the building up of external macroeconomic imbalances across the Euro area countries

➔ External debt denominated in a common currency

2.

Finance-dominated capitalism in the Euro area: rising inequality and macroeconomic imbalances

Figure 1



Note: Values for 2012 are European Commission forecasts.

Table 1

Gini coefficient before taxes for households' market income							
Country	mid-80s	around 1990	mid-90s	around 2000	mid-2000s	late 2000s	Change from mid-80s/around 1990/mid 90s until late 2000s
Austria	..	..	..	..	0.433	0.472	..
Belgium	0.449	..	0.472	0.464	0.494	0.469	0.020
Finland	0.387	..	0.479	0.478	0.483	0.465	0.078
France	..	..	0.473	0.490	0.485	0.483	0.010
Germany	0.439	0.429	0.459	0.471	0.499	0.504	0.065
Greece	0.426	..	0.446	0.466	0.454	0.436	0.010
Ireland	..	..	..	..	..		..
Italy	0.420	0.437	0.508	0.516	0.557	0.534	0.114
Netherlands	0.473	0.474	0.484	0.424	0.426	0.426	-0.047
Portugal	..	0.436	0.49	0.479	0.542	0.521	0.085
Spain	..	..	..	..	..	0.461	..

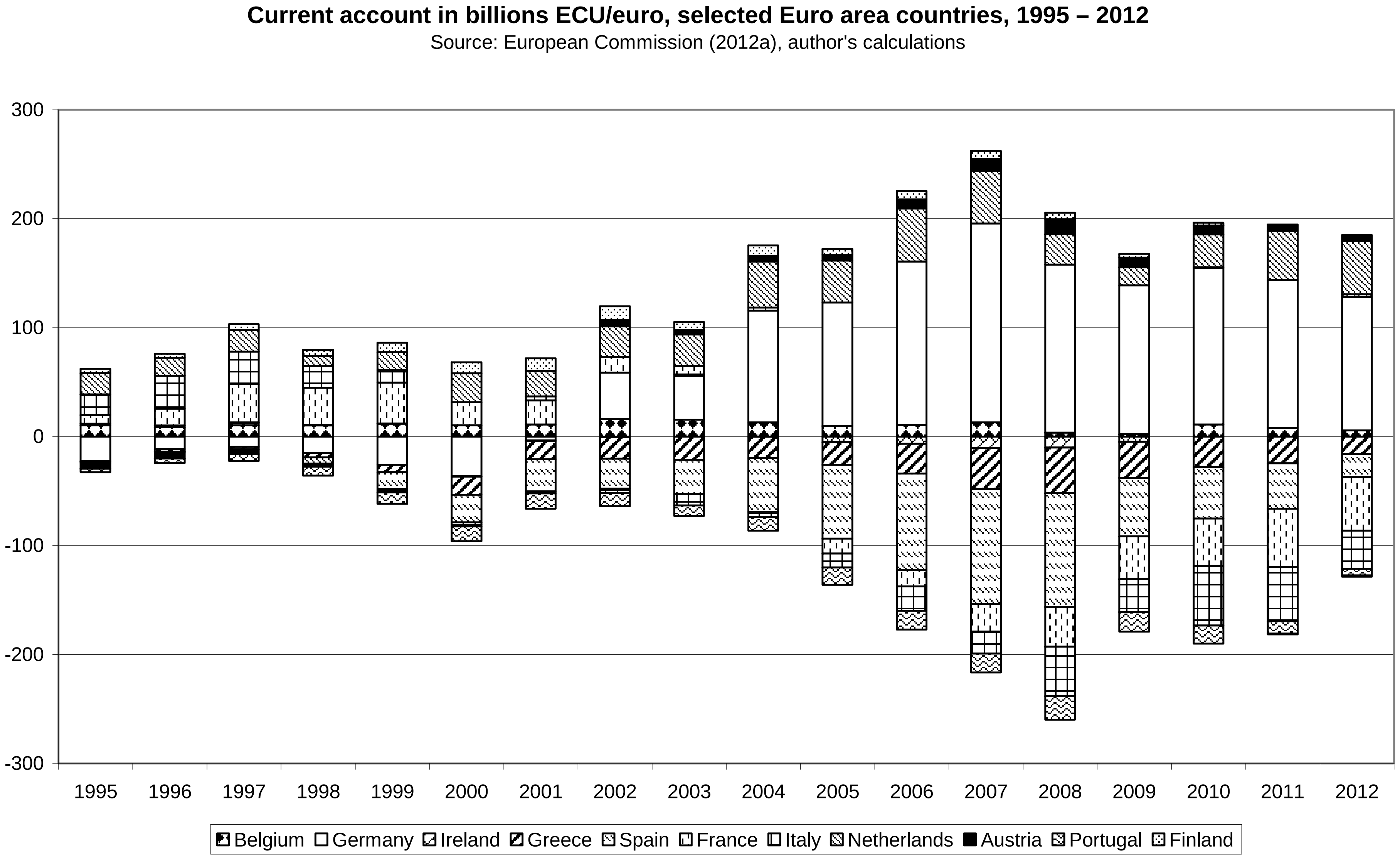
Table 1 continued

Gini coefficient after taxes for households' disposable income

Country	mid-80s	around 1990	mid-90s	around 2000	mid-2000s	late 2000s	Change mid-80s/around 1990 until late 2000s
Austria	0.236	..	0.238	0.252	0.265	0.261	0.025
Belgium	0.274	..	0.287	0.289	0.271	0.259	-0.015
Finland	0.209	..	0.218	0.247	0.254	0.259	0.050
France	0.300	0.290	0.277	0.287	0.288	0.293	-0.007
Germany	0.251	0.256	0.266	0.264	0.285	0.295	0.044
Greece	0.336	..	0.336	0.345	0.321	0.307	-0.029
Ireland	0.331	..	0.324	0.304	0.314	0.293	-0.038
Italy	0.309	0.297	0.348	0.343	0.352	0.337	0.028
Netherlands	0.272	0.292	0.297	0.292	0.284	0.294	0.022
Portugal	..	0.329	0.359	0.356	0.385	0.353	0.024
Spain	0.371	0.337	0.343	0.342	0.319	0.317	-0.054

Note: Gini coefficient is based on equivalised household income
Source: OECD (2012), author's calculations

Figure 2



Note: Values for 2012 are European Commission forecasts.

‘Types of capitalism under financialisation’

1. ‘debt-led consumption boom’ type

➔ Greece, Ireland, Spain

2. ‘export-led mercantilist’ type

➔ Austria, Belgium, Finland, Germany, Netherlands

3. ‘domestic demand-led’ type

➔ France, Italy, Portugal, EU-12

3.

Euro crises and deflationary stagnation policies

In the course of the 2008/09 crisis government deficits increased in order to stabilise the private real and financial sectors and government debt-GDP ratios jumped up

Mainstream interpretation (Germany, EU Commission, European Council)

➔ crisis of government deficits and debt

Prevention of collapse of financial market

- Greek rescue facility, EFSM, EFSF, ESM
- Extension of stabilisation tools of EFSF and ESM: Re-capitalize financial institutions via governments, intervene in secondary government bonds markets
- ECB intervention into secondary government bonds market, but no explicit guarantee of Euro area member countries governmet debt

But

- No solution to institutional deficiencies
- ECB Interventions into government bond markets are criticized by Germany, in particular
- No steps towards eurobonds or something similar

- Austerity policy as a condition for access to rescue packages, and for future ECB interventions
- Tighter SGP (Six-Pack)
- Euro Plus Pact
- Fiscal Compact

➔ Structural budget deficit below 0.5 per cent of GDP to be introduced into constitutions

➔ Automatic sanctions, if 0.5 per cent (structural deficit) or 3 per cent (overall deficit) is breached

➔ reduce government debt exceeding the 60 per cent of GDP threshold by 1/20 per year

➔ improve competitiveness through wage moderation, use public sector wage contracts as a tool

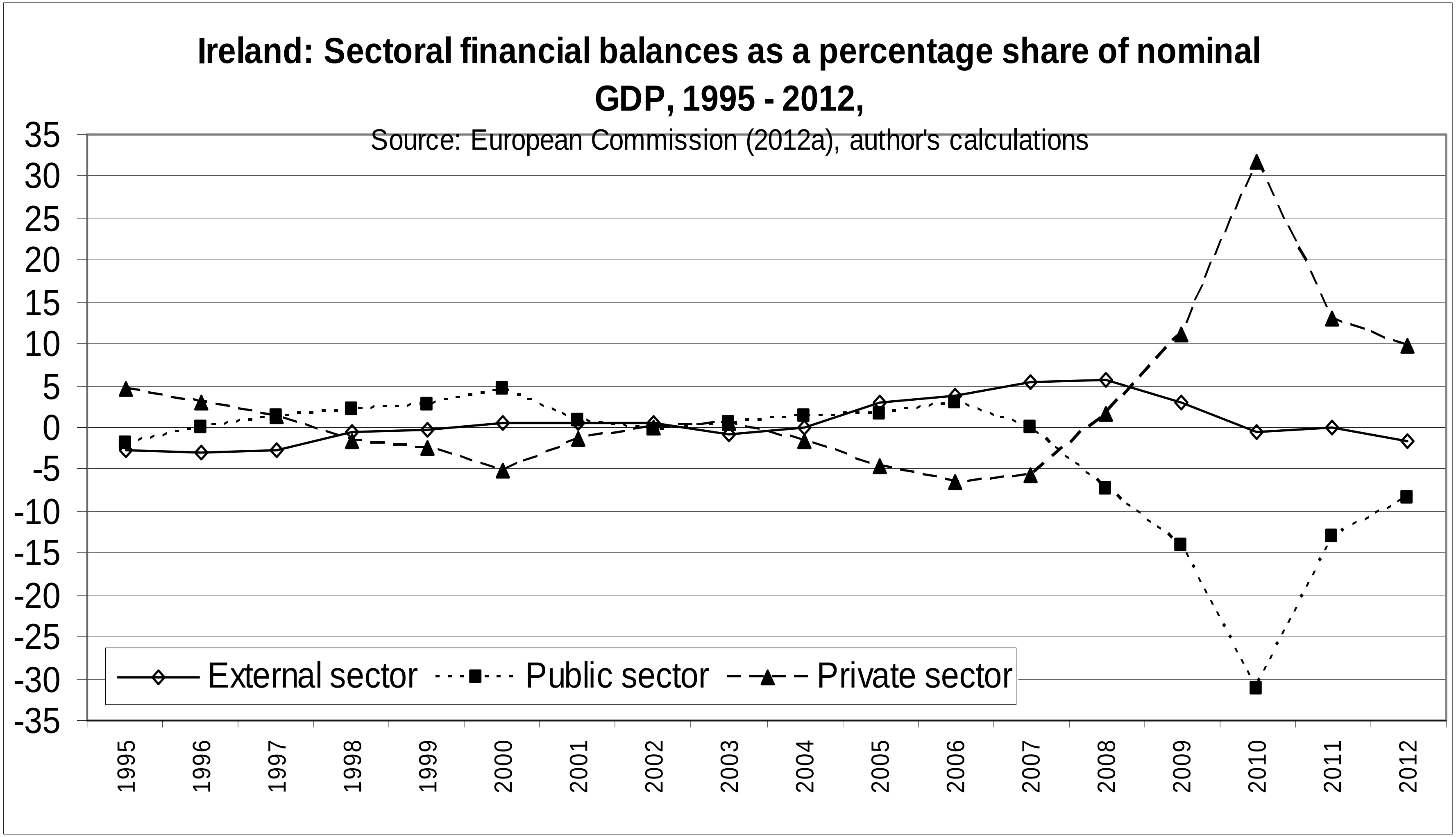
Problem

Measures do not address institutional deficiencies - and they do not meet the facts with respect to the causes of the crisis

  Public sector financial balance
+ Private sector financial balance
+ Foreign sector financial balance
= 0

➔ Public sector deficit (debt) maybe a consequence, but not the cause of the crisis

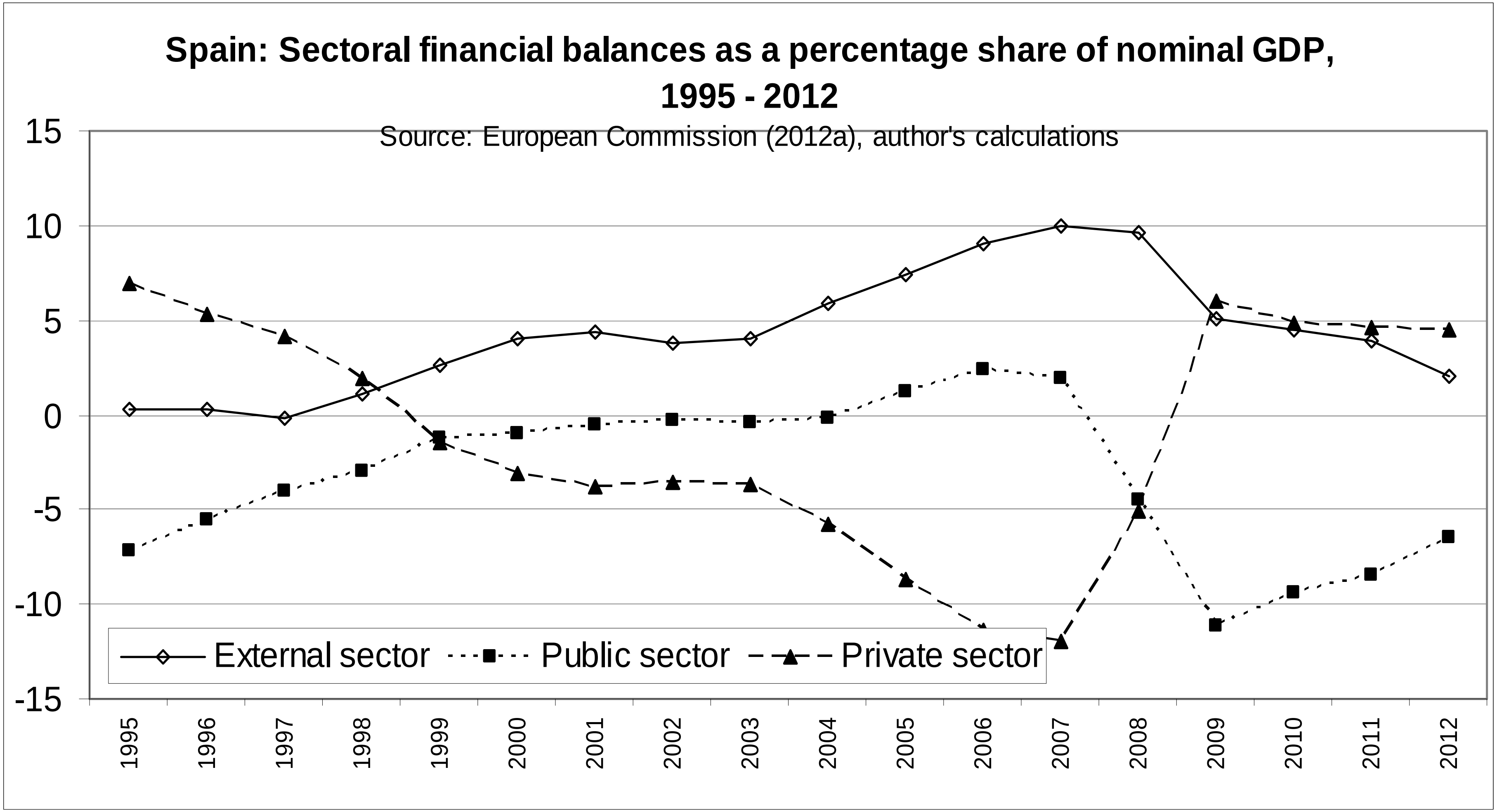
Figure 7



Note: Values for 2012 are based on European Commission forecasts.

Public sector surpluses before the crisis turn negative when private sector turns positive in the crisis …

Figure 8



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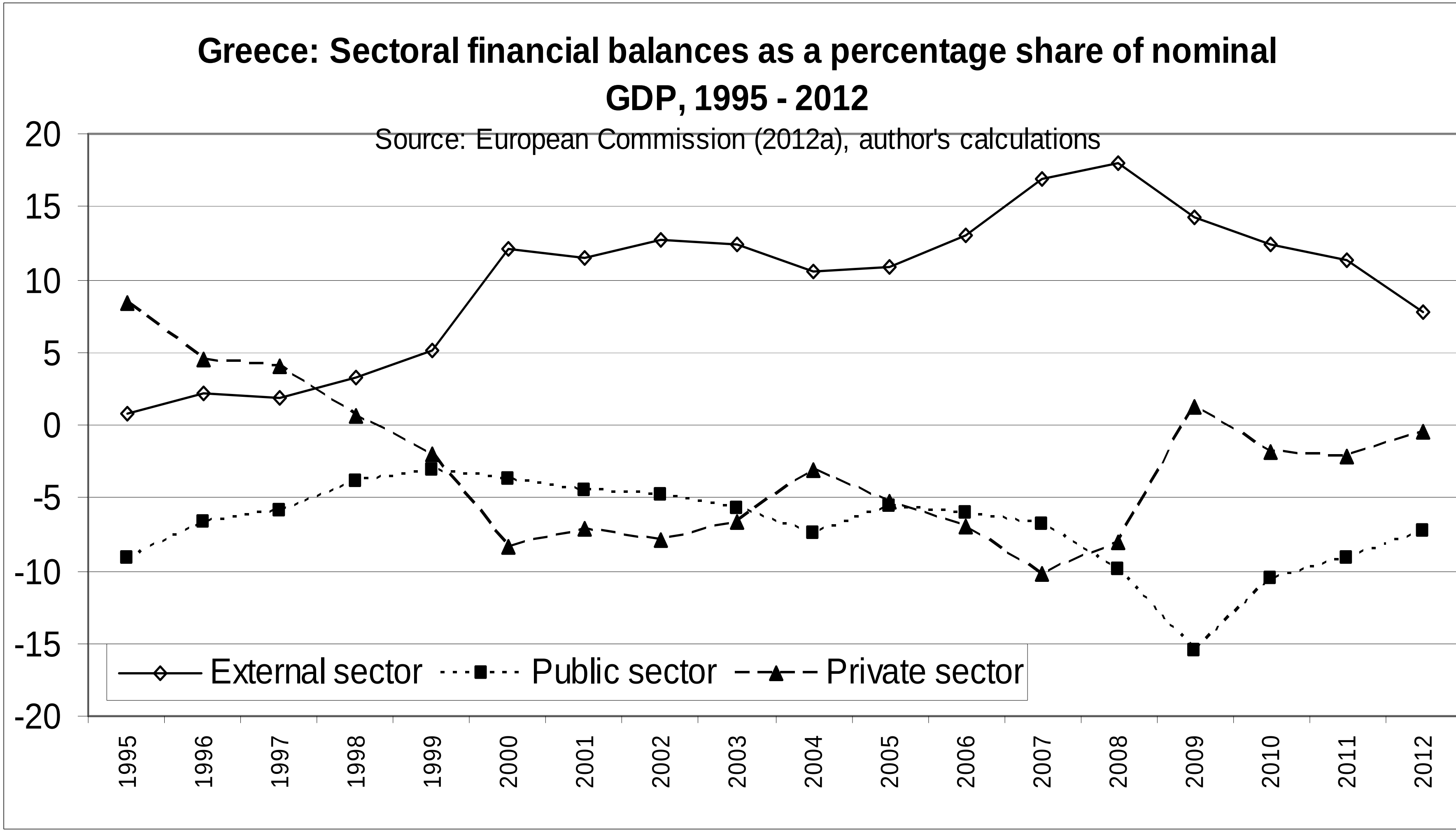
Public sector surpluses before the crisis turn negative when private sector turns positive in the crisis …

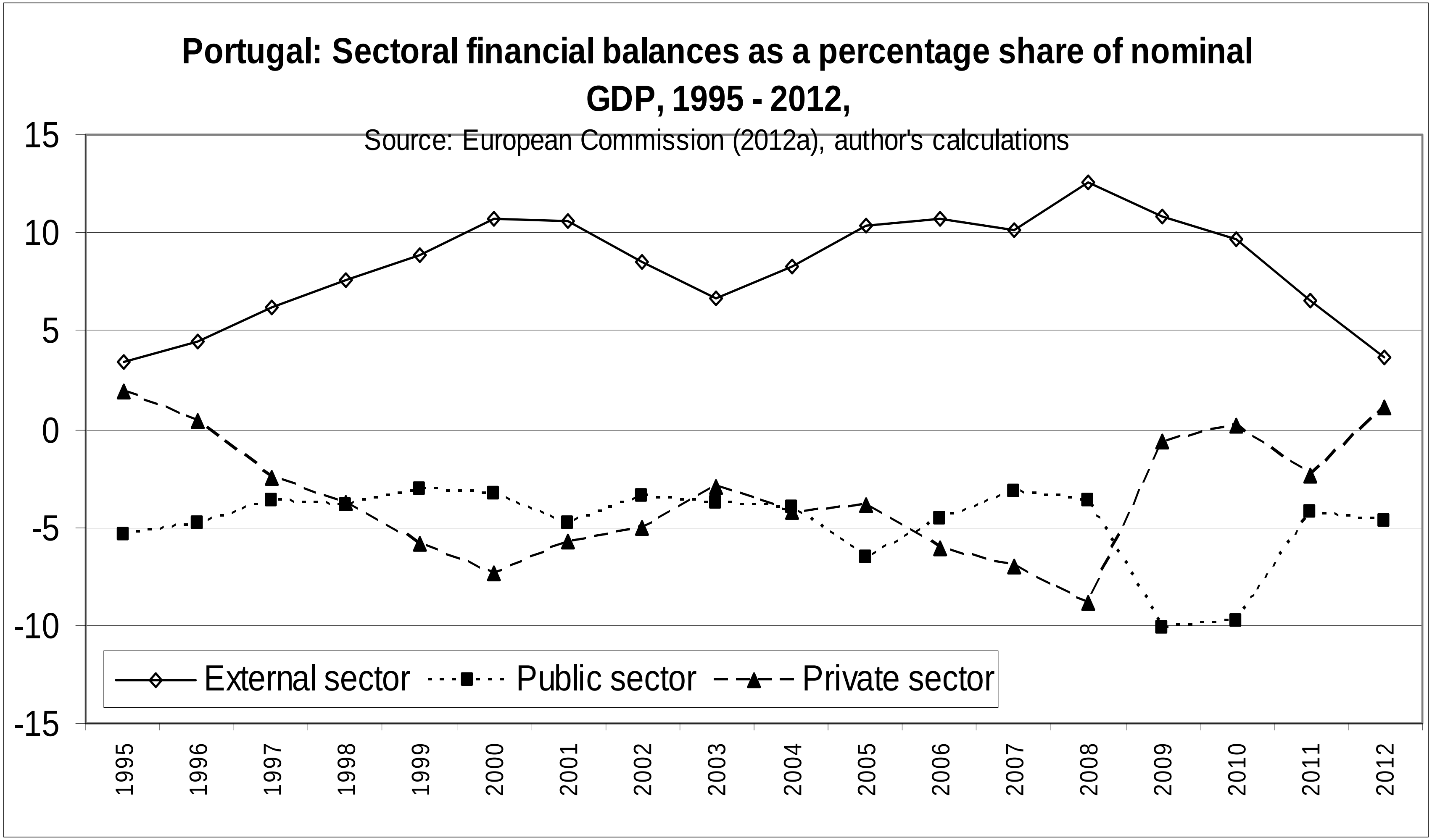
Figure 9



Note: Values for 2012 are based on European Commission forecasts.

Private and public sector deficits before the crisis, public sector deficits increase when private sector improves in the course of the crisis

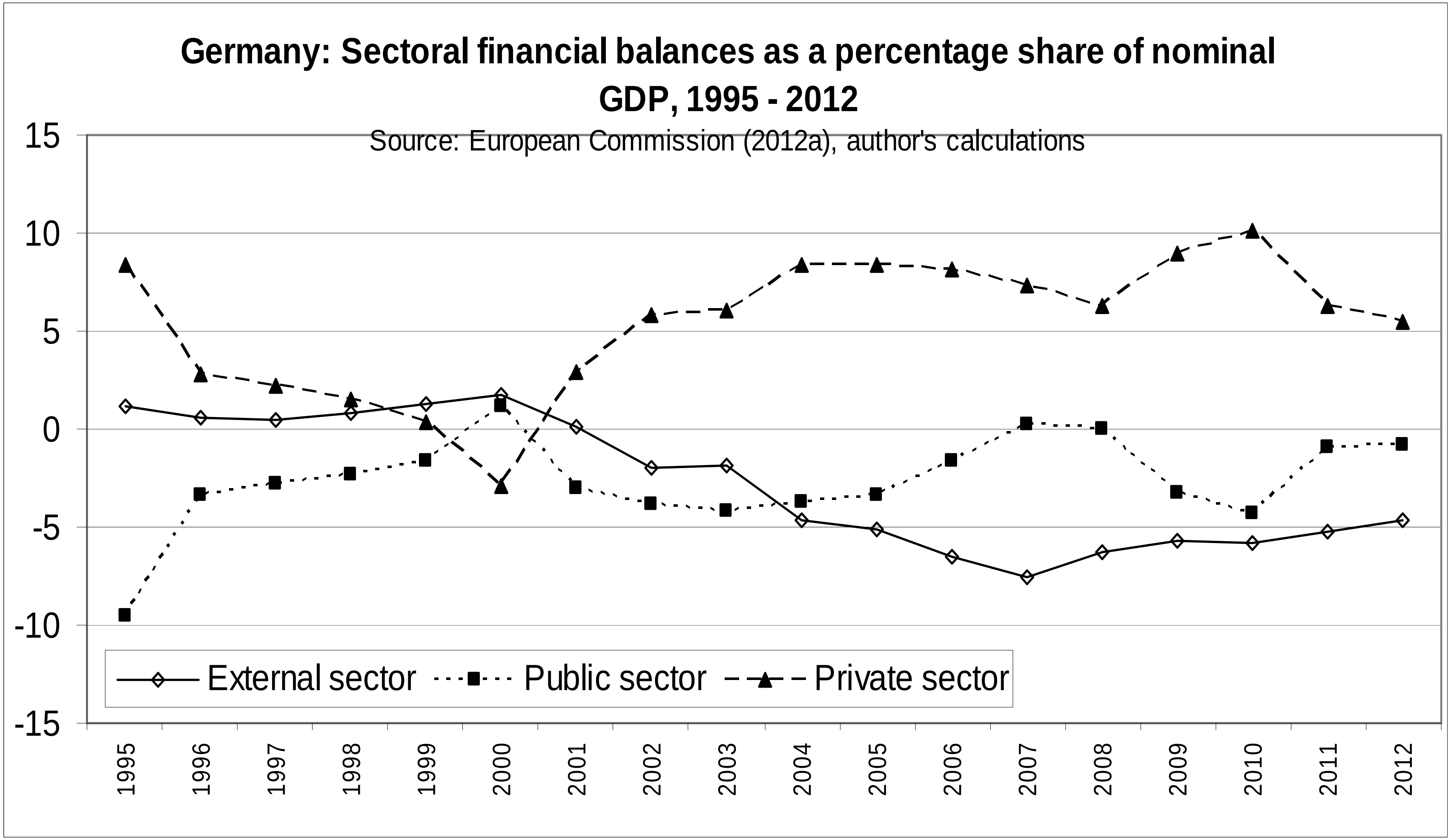
Figure 10



Note: Values for 2012 are based on European Commission forecasts.

Private and public sector deficits before the crisis, public sector deficits increase when private sector improves in the course of the crisis.

Figure 11



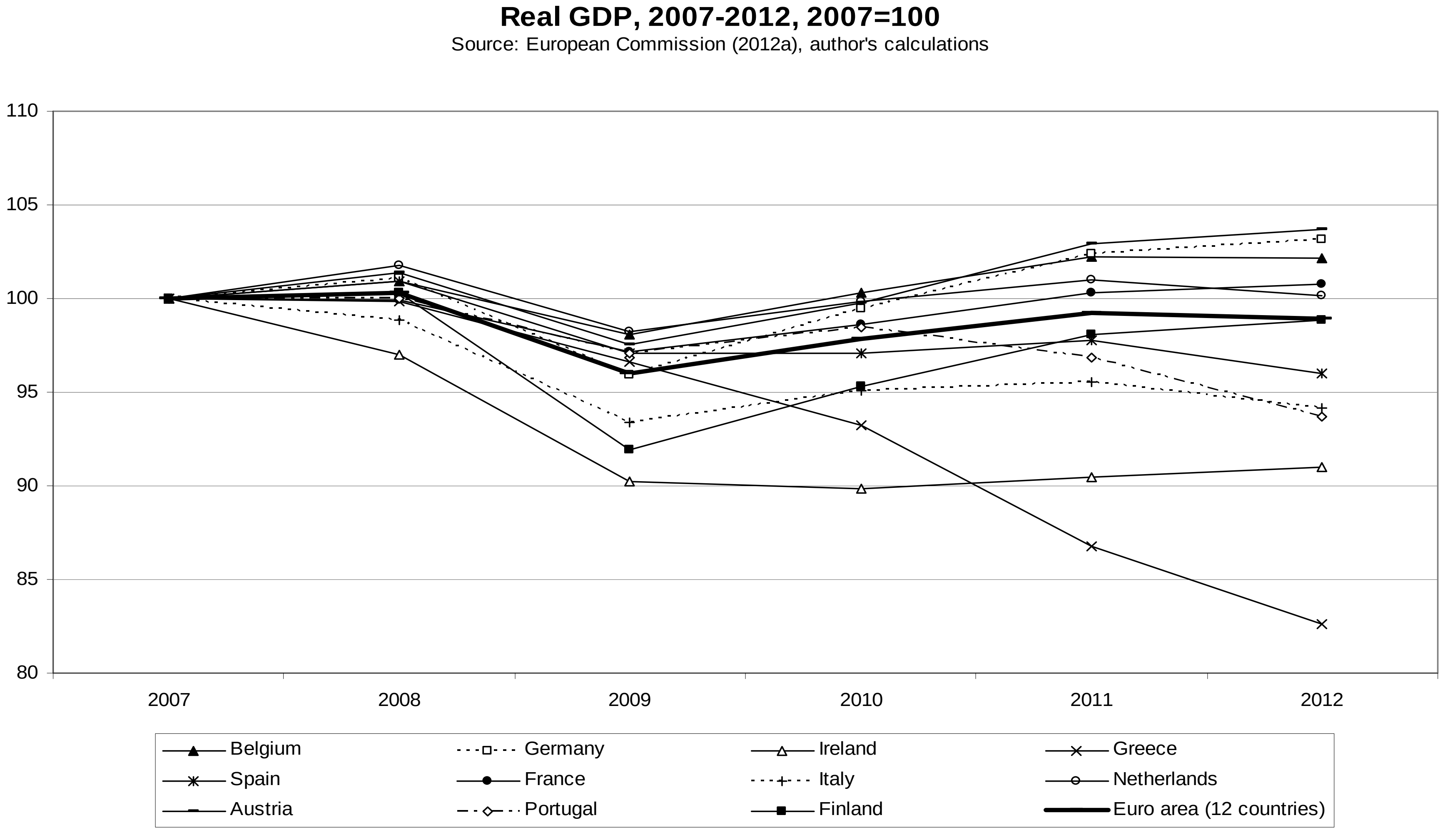
Note: Values for 2012 are based on European Commission forecasts.

Germany, and the other ‚export-led mercantilist' economies as counterparts …

Private sector surpluses and external sector deficits

The effects of deflationary stagnation policies: no recovery to pre-crisis GDP in Greece, Ireland, Portugal, Spain, Italy and Finland

Figure 3



Note: Values for 2012 are based on European Commission forecasts.

Table 3a

Key macroeconomic variables for 'debt-led consumption boom' economies, average values, 2008 – 2012 [b)]			
	Greece	**Ireland**	**Spain**
Annual change in labour income share, as percentage of GDP at current factor costs	-1.1	-0.3	-0.9
Financial balances of external sector as a share of nominal GDP, per cent	12.7	1.3	5.0
Financial balances of public sector as share of nominal GDP, per cent	-10.5	-14.8	-8.0
Financial balance of private sector as a share of nominal GDP, per cent	-2.3	13.5	3.0
Financial balance of private household sector as a share of nominal GDP, per cent [a)]	-10.6	4.1	3.2
Financial balance of the corporate sector as a share of nominal GDP, per cent	8.3	9.4	0.3
Real GDP growth, per cent	-3.7	-1.8	-0.8
Growth contribution of domestic demand including stocks, percentage points	-5.7	-4.8	-2.9
Growth contribution of private consumption, percentage points	-2.0	-1.4	-0.8
Growth contribution of public consumption, percentage points	-0.9	-0.5	0.0
Growth contribution of gross fixed capital formation, percentage points	-2.4	-2.9	-2.1
Growth contribution of the balance of goods and services, percentage points	2.1	3.1	2.1
Net exports of goods and services as a share of nominal GDP, per cent	-9.5	17.7	-1.8
Growth rate of nominal unit labour costs, per cent	0.3	-1.6	0.0
Inflation (HCPI growth rate), per cent	2.6	0.5	2.2
Growth rate of nominal effective exchange rates (relative to 35 countries), per cent	0.3	-0.1	0.0
Growth rate of real effective exchange rates (relative to 35 countries), per cent	-1.8	-3.6	-2.1

Note: [a)] adjusted such that private household plus corporate balances sum up to private sector balance, [b)] values for 2012 are based on forecasts by the European Commission (2012a)
Source: European Commission (2012a), author's calculations

Fall in labour income shares, collapse in domestic demand, improved competitivenes based on wage restraints and cuts, decline in current account deficits, which persist, with the exception of Ireland.

Table 3b

Key macroeconomic variables for 'export-led mercantilist' economies, average values, 2008 – 2012 [b]					
	Austria	**Belgium**	**Finland**	**Ger-many**	**Nether-lands**
Annual change in labour income share, as percentage of GDP at current factor costs	0.6	0.5	0.9	0.8	0.4
Financial balances of external sector as a share of nominal GDP, per cent	-2.9	-1.7	-1.1	-5.5	-5.6
Financial balances of public sector as share of nominal GDP, per cent	-3.0	-3.5	-0.6	-1.9	-3.8
Financial balance of private sector as a share of nominal GDP, per cent	6.0	5.2	1.7	7.4	9.5
Financial balance of private household sector as a share of nominal GDP, per cent [a]	4.2	4.0	-2.3	5.7	0.7
Financial balance of the corporate sector as a share of nominal GDP, per cent	1.8	1.2	4.0	1.7	8.7
Real GDP growth, per cent	0.9	0.5	-0.1	0.7	0.0
Growth contribution of domestic demand including stocks, percentage points	0.8	0.6	0.6	0.8	-0.2
Growth contribution of private consumption, percentage points	0.5	0.6	0.8	0.4	-0.3
Growth contribution of public consumption, percentage points	0.3	0.2	0.2	0.4	0.4
Growth contribution of gross fixed capital formation, percentage points	0.0	-0.1	-0.4	0.1	-0.3
Growth contribution of the balance of goods and services, percentage points	0.2	-0.1	-0.7	-0.2	0.3
Net exports of goods and services as a share of nominal GDP, per cent	4.2	1.8	1.0	5.3	7.9
Growth rate of nominal unit labour costs, per cent	2.5	2.8	3.5	2.2	2.1
Inflation (HCPI growth rate), per cent[a]	2.3	2.6	2.7	1.8	1.8
Growth rate of nominal effective exchange rates (relative to 35 countries), per cent	-0.2	-0.1	-0.4	-0.3	0.0
Growth rate of real effective exchange rates (relative to 35 countries), per cent	0.1	0.6	1.0	-0.2	0.0

Note: [a] adjusted such that private household plus corporate balances sum up to private sector balance, [b] values for 2012 are based on forecasts by the European Commission (2012a)
Source: European Commission (2012a), author's calculations

Rising labour income shares as a stabiliser of aggregate demand, positive growth contributions of domestic demand (not NL), net exports and current accounts remain positive, although price competitiveness has suffered (exception is Germany and NL)

Table 3c

Key macroeconomic variables for 'domestic demand-led' economies, average values, 2008 – 2012 [b]				
	France	**Italy**	**Portugal**	**EU-12**
Annual change in labour income share, as percentage of GDP at current factor costs	0.6	0.4	-0.5	0.4
Financial balances of external sector as a share of nominal GDP, per cent	2.3	2.7	8.7	0.0
Financial balances of public sector as share of nominal GDP, per cent	-5.5	-3.7	-6.5	-4.4
Financial balance of private sector as a share of nominal GDP, per cent	3.3	0.9	-2.1	4.5
Financial balance of private household sector as a share of nominal GDP, per cent [a]	4.3	2.2	2.5	…
Financial balance of the corporate sector as a share of nominal GDP, per cent	-0.9	-1.3	-4.6	…
Real GDP growth, per cent	0.2	-1.2	-1.3	-0.2
Growth contribution of domestic demand including stocks, percentage points	0.2	-1.5	-3.0	-0.6
Growth contribution of private consumption, percentage points	0.3	-0.4	-1.2	0.0
Growth contribution of public consumption, percentage points	0.3	0.0	0.0	0.2
Growth contribution of gross fixed capital formation, percentage points	-0.3	-0.8	-1.4	-0.6
Growth contribution of the balance of goods and services, percentage points	0.0	0.3	1.7	0.4
Net exports of goods and services as a share of nominal GDP, per cent	-2.4	-1.0	-5.8	1.4
Growth rate of nominal unit labour costs, per cent	2.2	2.3	0.2	1.9
Inflation (HCPI growth rate), per cent	1.9	2.4	1.9	2.0
Growth rate of nominal effective exchange rates (relative to 35 countries), per cent	-0.3	-0.3	-0.1	-0.5 [c]
Growth rate of real effective exchange rates (relative to 35 countries), per cent	0.0	0.1	-1.5	-0.6 [c]

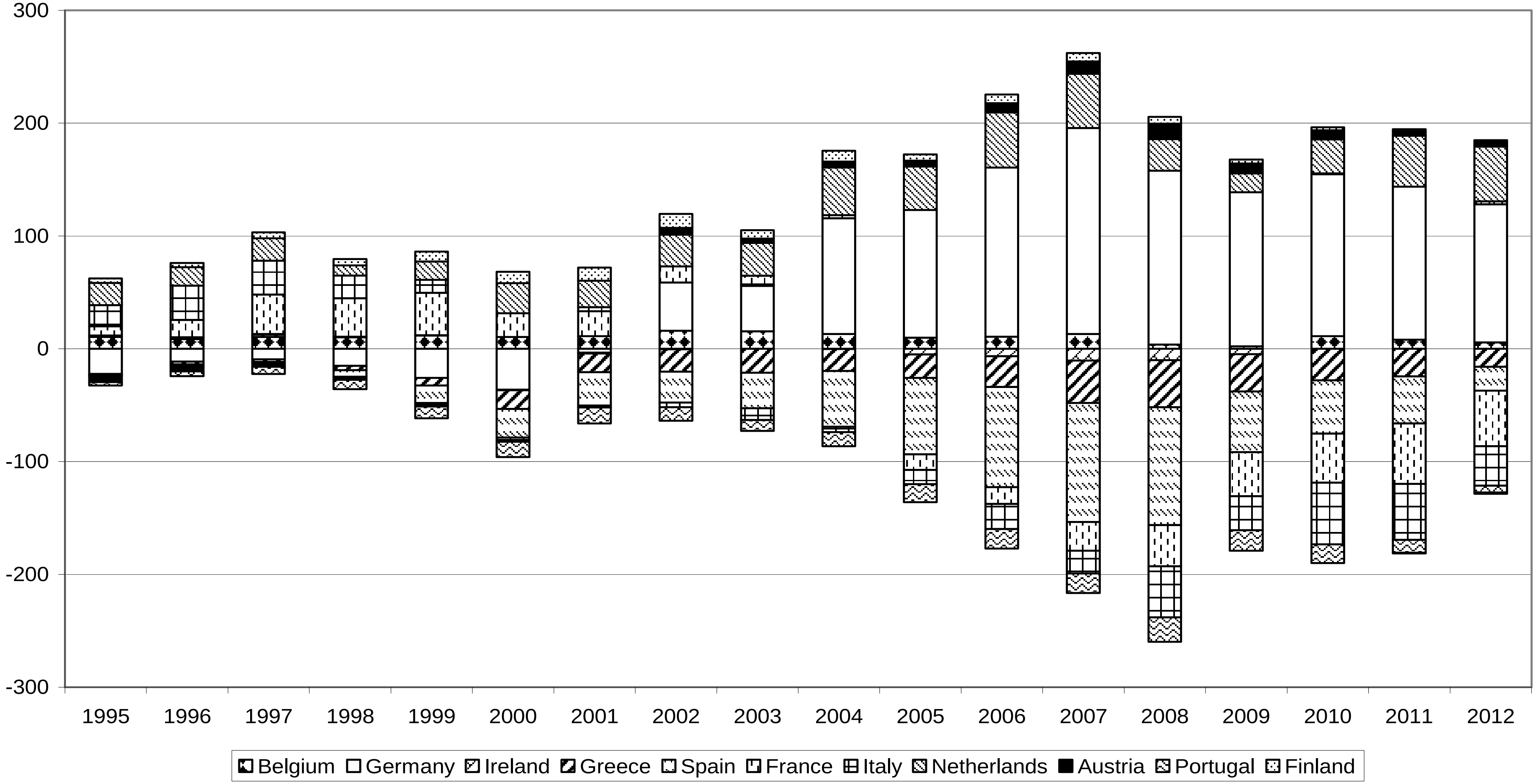
Notes: [a] adjusted such that private household plus corporate balances sum up to private sector balance, [b] values for 2012 are based on forecasts by the European Commission (2012a), [c] relative to 21 countries
Source: European Commission (2012a), author's calculations

Portugal like Greece, Ireland, Spain; France: increase in labour income share, stabilisation of domestic demand, but deterioration of net exports and current account; Italy: increase in labour income share, collapse of domestic demand, deterioration of net exports and current account

Current account imbalances reduced but still of considerable dimension

Figure 2

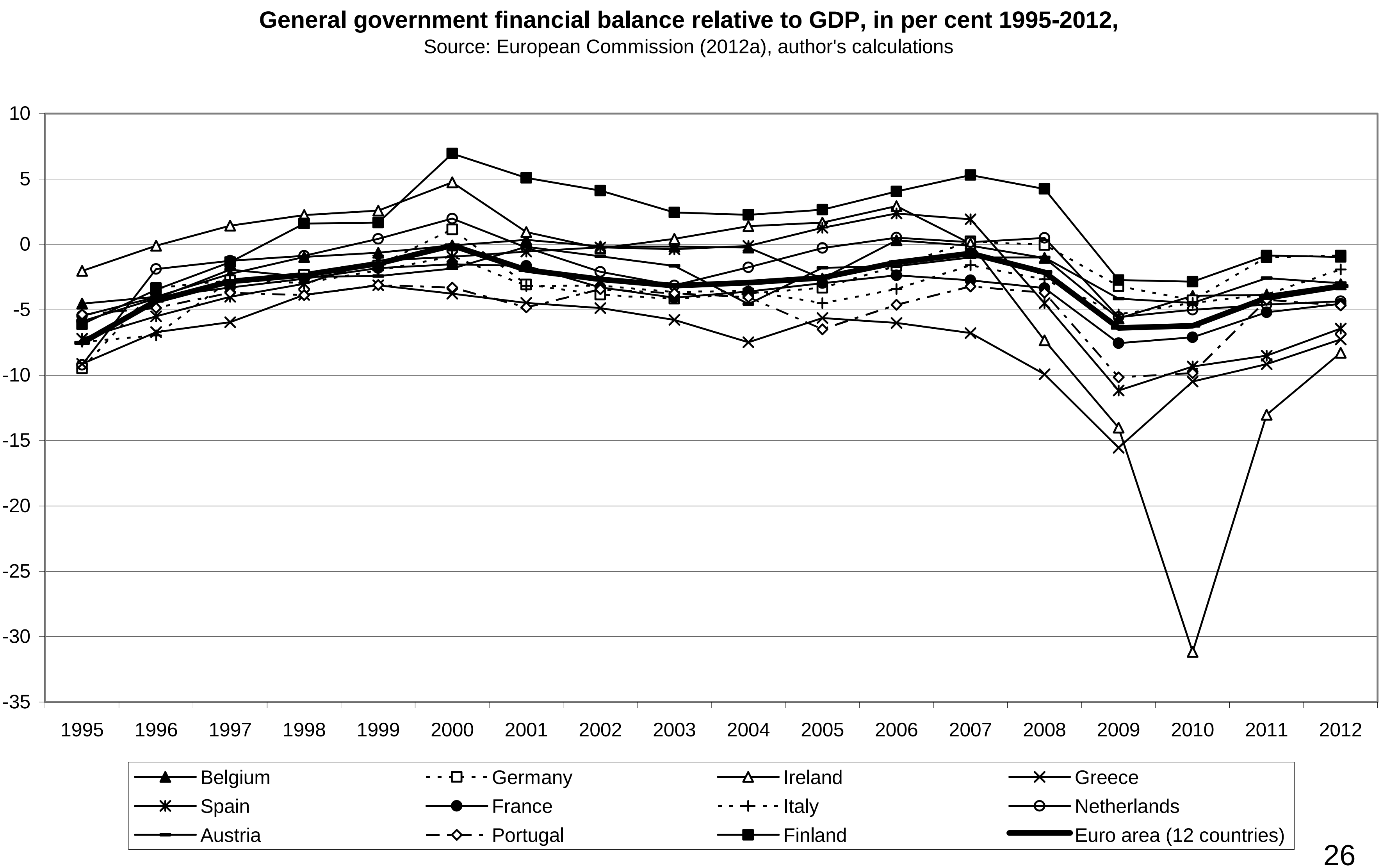
Current account in billions ECU/euro, selected Euro area countries, 1995 – 2012
Source: European Commission (2012a), author's calculations



Note: Values for 2012 are European Commission forecasts.

Reduction in government deficit-GDP ratios …

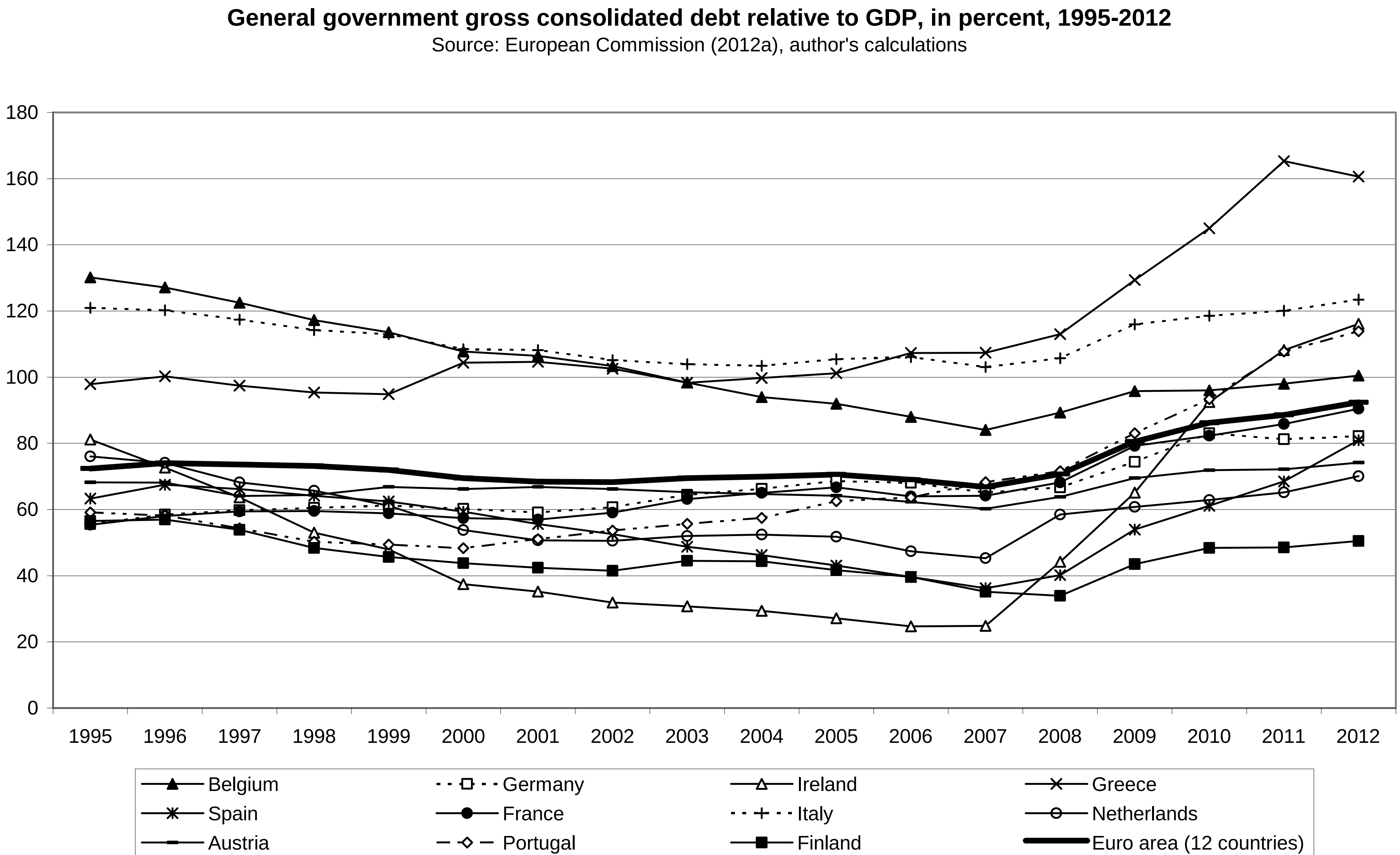
Figure 4



Note: Values for 2012 are based on European Commission forecasts.

but increasing government debt-GDP ratios ..

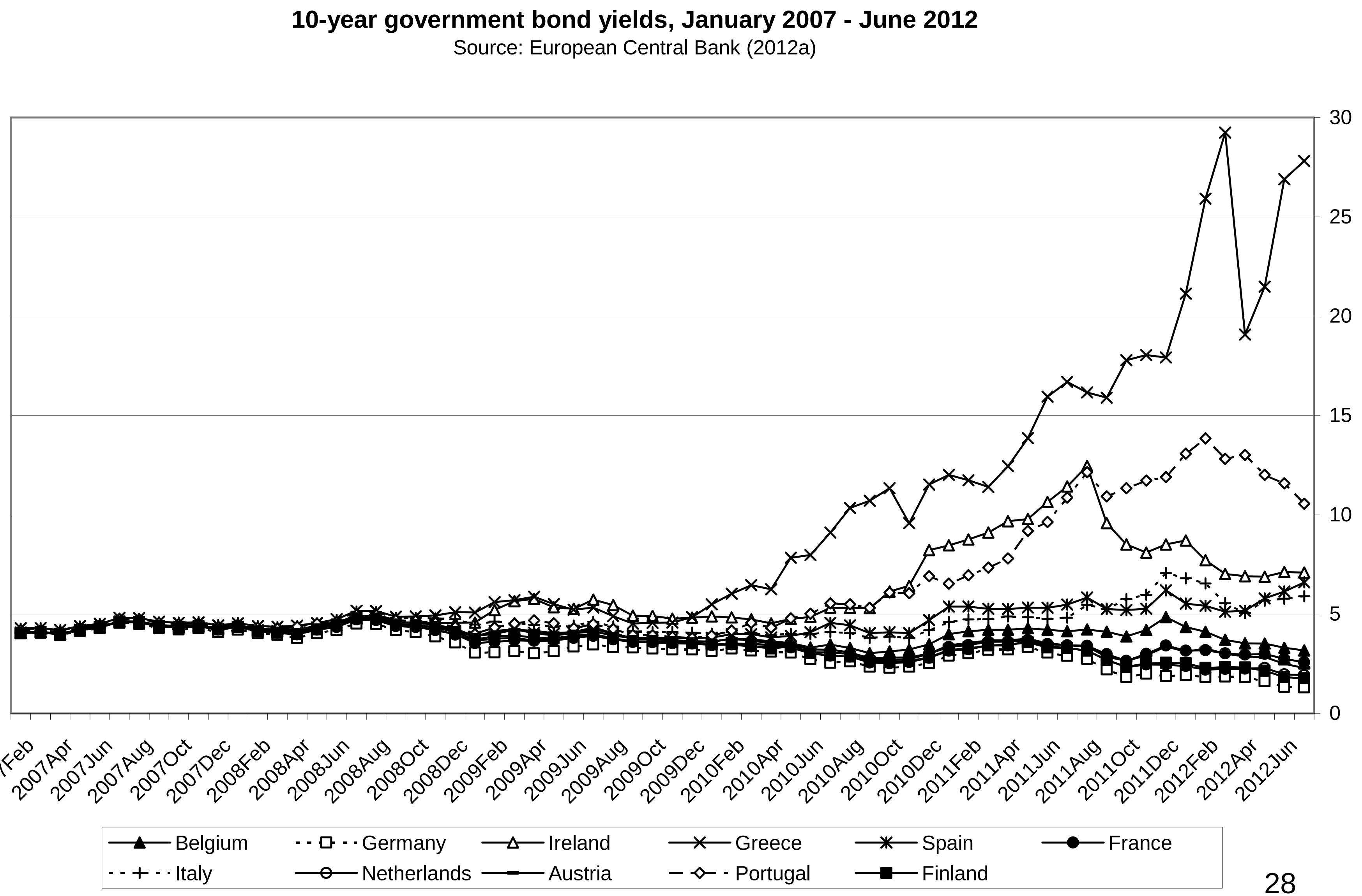
Figure 5



Note: Values for 2012 are based on European Commission forecasts.

Persistent interest rate spreads, rates in Italy and Spain rising since spring 2012 ….

Figure 6



Deflationary stagnation policies in the Euro area since 2010 have meant

• massive real GDP losses (and related increases in unemployment not discussed here) in the former debt-led consumption boom economies as well as in Portugal and Italy, due to a policy induced (further) collapse of domestic demand;

• some improvement in price competitiveness of these countries due to deflationary wage developments, with the exception of Italy;

• some improvements in the current accounts, however, with considerable current account imbalances persisting in the Euro area as a whole and with rising surpluses of the Euro area with RoW;

• reductions in government deficit-GDP ratios but continuously rising trends in government debt-GDP ratios;

• persistent differentials in government bond yields;

• the risk of a further recession for the Euro area as a whole in 2012/13

• and an increasing risk of a final collapse of the euro as a currency.

4.

Alternatives to deflationary stagnation policies

Getting out of the crisis means addressing the long-run developments of FDC

- the inefficient regulation of financial markets
- the increased inequality in income distribution
- the imbalances in the current accounts at the global and the European level

+ overcoming the institutional deficiencies in the Euro area, which made the financial + economic crises a euro crisis

Keynesian New Deal at Global and European level

- the re-regulation of the financial sector
- re-orientation of macroeconomic policies
- re-construction of international macroeconomic policy co-ordination and a new world financial order

1. ECB monetary policies

a) Guarantee public debt

- The ECB should not only act as a lender of last resort for the banking system, it should also guarantee public debt of the Euro area member countries, allowing these countries to issue debt in their ‘own currency’
- announce that it will intervene into secondary government bond markets as soon as the rate of interest on government bonds exceeds the long-run nominal rate of growth of the respective country

b) Reform of ECB monetary policy strategy

- take into account long-run distribution, employment and growth effects and refrain from fine-tuning inflation or other macro-variables
- target low real long-term interest rates

c) Focus on financial stability

2. Fiscal policies and its coordination

- Abandon SGP and replace it by coordination of fiscal policies along functional finance lines taking into account balance of payments considerations
- coordinate expenditure paths for non-cyclical government spending such that aggregate demand in each country allows for non-inflationary full employment
- actively coordinated counter-cyclical policies in case of shock

➔ on average over the cycle, and the average net tax rate given, government deficits in each country should roughly balance private sector surpluses (or deficits) G-T = S-I

➔ contribute to GDP growth close to BoP constrained growth rate (X-M = 0)

3. Labour market and wage setting

- Abandon the dominating policies of labour market flexibilisation and of gaining competitiveness by means of nominal wage restraints (cuts)
- Re-regulation of labour market, stabilisation of labour unions and employer associations, Euro-area wide minimum wage legislation
- Wage norm for wage bargaining co-ordination:

nominal wage growth = national average trend of productivity growth + inflation target

➔ contribute to stable wage share
➔ prevent neo-mercantilist strategies

4. Overcome present imbalances

- adjust actual growth and balance of payments (BoP) constrained growth rates

Current account surplus countries:
- Expansionary fiscal policies beyond the norm for fiscal policies
- Increase inflation rates relative to deficit countries, i.e. increase nominal wages beyond the norm for wage setting

Current account deficit countries:
- Reduce inflation differential to surplus countries, i.e. lower unit labour costs growth below target inflation rate for the Euro area as a whole
- Increase income elasticity of exports (Italy, France, Portugal)
- Decrease income elasticity of imports (Greece, Spain, Portugal)

➔ Industrial, structural + regional policies

➔ ECB: Increase inflation target to allow for adjustment without deflation

5. Take long-run growth differentials (due to catching-up..) into account

- No compensation by reverse inflation differentials or inverse relative income elasticities of demand for exports and imports
➔ deviation of GDP growth from BoP constrained growth rate

- Current account deficits and surpluses which should be tolerated by coordinated economic policies

➔*Criterion for tolerable CA deficits: growth of deficit country is sustainable and exceeds average growth of surplus countries*

➔ Foreign liabilities-GDP-ratio of deficit country will not explode

6. Provide stable financial transfers from slowly growing mature economies to catching up economies

- Avoid asset price inflation and credit bubbles

- Accelerate catching up

- European Investment Bank, European Regional and Structural funds, industrial and regional policies

5.
Conclusions

The survival of the euro and the prevention of further deflationary stagnation in the Euro area requires key changes in the economic policy architecture and strategies:

1. a central bank which convincingly guarantees public debt of Euro area member countries and which contributes to improved Euro area growth by means of targeting low real interest rates,

2. fiscal policies along functional finance lines will have to be applied and coordinated across the Euro area, taking our criterion for long-run acceptable current account deficits (and surpluses) on board,

3. wage and incomes policies should contribute to nominal stabilisation, prevent mercantilist strategies and the related imbalances, as well as falling wage shares,

4. active industrial and regional policies will have to be applied in order to facilitate stable catch-up processes of the less developed countries and regions within the Euro area.

THE END