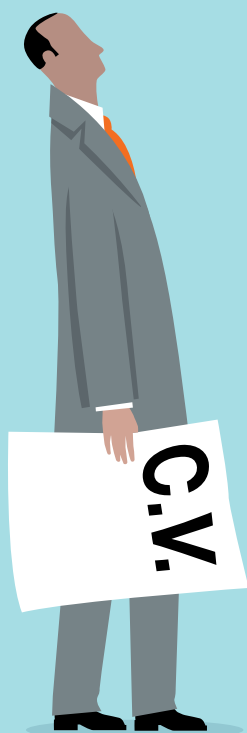


PROGRESSIVE ECONOMY

Can the ECB do more for Europe's unemployed? Monetary Policy and Labour Markets



Swoboda
Hughes
Fitoussi
Fassina
Katseli
Berès
Turunen
Ségol
Pickett
Vandenbroucke
Andersen
Horn
Timbeau
Bofinger
Saraceno
Wyplosz

- Growth in crisis
- Progressive labour markets
- Equal society
- The 2014 independent Annual Growth Survey



**The Progressive Economy Initiative was launched in 2012
and is supported by the Socialists and Democrats Group in the
European Parliament.**

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Group of the Progressive Alliance of
Socialists & Democrats
in the European Parliament

WHAT IS...

Progressive Economy



OBJECTIVE

Progressive Economy is a new initiative launched in 2012 with a major objective: to generate a truly public and informed debate on economic and social policy at European and national, as well as global, levels and actively promote progressive thinking in these areas at academic and at political levels. Progressive Economy is a long-term initiative with a strategic vision of its contribution to progressive thinking and action, not a one-off event.

Without public debate, without clear policy choices, there can be no real democracy. Lack of choice breeds frustration, populism and the growth of anti-politics. Progressives have a duty to demonstrate to citizens that they do have a choice and to do what it takes to win the battle of ideas in these core areas for the future of our societies.

That is why the S&D Group has launched the Progressive Economy initiative, which will create a new and open space for public and informed debate, and which will contribute to build a contemporary progressive economic and social vision for Europe.

ONGOING ACTIVITIES

The initiative started back in November 2012 with support given to the publication of the first **Independent Annual Growth Survey (iAGS)**. Each year, several economic institutes (OFCE, IMK, and ECLM) will publish an iAGS, providing detailed analysis, forecasts and recommendations for the European economy. The next iAGS will be released in November 2013. Progressive Economy is proud to support this work, which for the first time provides a solid alternative to the Commission's own Annual Growth Survey report that forms the basis for the annual definition of Europe's economic policy at European Council level, and of country-specific recommendations.

The initiative was then publicly launched at a first annual conference in Brussels on Thursday 7 March 2013, close to the Spring European Council, with high-level participants from politics, academia, media and civil society. The initiative will retain the concept of one major annual gathering, within which the different parts of its activities and the many people involved can come together. The next annual conference will take place in March 2014 in Brussels in the form of a **"Progressive Economy Forum"** under the theme **"INEQUALITY"**. The aim of this annual Forum is to bring together an ever larger number of progressive

individuals from academia, politics, trades unions and civil society actively engaged in, and committed to reinforcing and promoting progressive ideas in the economic and social fields across Europe and globally.

NEW ACTIVITIES

PEAC: The PEAC project is aimed at fostering progressive academic research and networking on economic and social issues, and at facilitating the transmission of academic knowledge into political processes (Progressive Economy Academic project), notably through an annual "Call for papers".

PEPA: The PEPA project is aimed at deepening and broadening the democratic dimension of European economic and social governance at EU, Eurozone and Member States' levels, and at contributing to a fundamental and durable change of policy in the economic and social fields in line with commonly defined progressive policy concepts and values (Progressive Economy Parliamentary Alliance). It includes an Annual PEPA Assembly, of which a first meeting is envisaged for 4-5 December 2013.

PROGRESSIVE ECONOMY EVENTS:

In order to contribute to an open and inclusive exchange of ideas and experiences among progressives across Europe, Progressive Economy will run a rich programme of events in different parts of Europe. In 2013, a series of successful and high-level events have already been held in Lisbon, Brighton, Bordeaux and Budapest.

POLICY ISSUES: Across its range of activities, the initiative will, in particular, address three policy issues, being: "Growth in Crisis", "Progressive Labour Markets", "Equal Society" and "Global Progressive Economy". Furthermore the initiative will aim at strengthening both knowledge and policy responses in these areas through tailored studies and a series of workshops.

JOURNAL FOR A PROGRESSIVE

ECONOMY: The initiative's activities will feed into a regular publication of contributions from academics, policymakers and other key stakeholders, the aim of which will be the circulation of progressive thinking and the transmission of knowledge and ideas between the academic and political spheres.

WEBSITE: The new Progressive Economy website will play an active role in developing the PEAC and PEPA projects and, more generally, in providing an important source of information and exchange for progressives on economic and social challenges.



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Contents

Forewords 07

- **Hannes Swoboda MEP** and **Stephen Hughes MEP**, President and Vice-President of the S&D Group in the European Parliament

Key Contribution 10

Europe: a child of the economy, an orphan of politics

- **Jean-Paul Fitoussi**, Professor of Economics, LUISS University, Rome

This article draws attention to the danger of governments that over-rely on budget deficit as the only solution to the complex socio-economic crisis which the EU is currently facing. Using the example of the great depression, Fitoussi argues that there is a danger of history repeating itself if the rights steps are not taken.

Policy Issues 14

Europe: In need of an alternative to neoliberalism

- **Stefano Fassina**, Secretary of State for Economic Affairs, Italy

The author draws attention to the mistakes of the past in order to understand the current crisis in Europe. He argues the public debt of southern European states was a problem well before the US financial crisis in 2007. The disparities in the economic performances and capabilities of Eurozone states have created a vicious cycle which has been exacerbated following neo-liberal assumptions of a speedy recovery.

How Should the EU Exit the Crisis?

- **Louka Katseli**, Professor of Economics, Athens University, former Minister for Social Affairs

This article offers a no-nonsense explanation of the economic crisis in Europe including, how we got here, the social-economic impact and how to avert this crisis. Instead of postponing the decision making on debt recovery she argues for a progressive EU approach to structural reforms in taxation, public administration governance and regulatory systems.

Progressive labour markets - an old and a new battlefield

- **Pervenche Berès MEP** Chairperson of the European Parliament's Committee for Employment and Social Affairs and **Emilie Turunen MEP**

The authors for a new progressive and pro-active agenda on labour markets. In times of high unemployment and severely constrained public resources, neoliberal attacks on labour market rules and institutions, and on wages in a number of member states, are not only socially but also economically damaging. However, the success of the neo-liberal narrative in dominating public discourse should be a harsh wake up call for progressives.

The European Central Bank and the Progressive Labour Market

- **Bernadette Ségol**, Secretary General, European Trade Union Confederation (ETUC)

Critical of the current ECB approach to the euro crisis, Ségol the author argues that the 'mainstream' economic ideas of scholars and by institutions such as the IMF contradict one another. She points to four key principles that are essential for a labour market; stability, security, fairness and progress.

Reducing inequality: an essential step for development and wellbeing

- **Kate Pickett**, Professor of Health Sciences, York University

In this groundbreaking article, the author notes the domino effect of problems which are created as a result of social and economic inequalities within societies. Through addressing issues such as tax evasion, she argues that reducing inequality is the most important step which needs to be taken in order to protect and enhance the well-being of citizens.

European Social Union: a political necessity and an urgent research programme

- **Frank Vandenbroucke**, Professor of Economics, KU Leuven University, former Minister for Social Security, Health Insurance, Pensions and Employment

The author provides a platform to view the effects and solutions to the crisis from a social dimension. He argues that having a basic EU consensus in relation to the welfare state is crucial for economic sustainability in the Eurozone. Through initiatives such as establishing a common minimum wage, this provides social investment with long term benefits for all.

iAGS 2014 - Preview 51

IAGS-2014 - Choosing policy coordination or structural divergence?

■ **Lars Andersen**, Director of ECLM Copenhagen, **Gustav Horn**, Director of IMK Düsseldorf, and **Xavier Timbeau**, Director at OFCE Paris

This sneak-peak at the upcoming iAGS 2014 draws attention to the flaws in the current strategy adopted by the EU in relation to the economic crisis; and stresses the importance of enhancing the coordination between EMU countries in order to reduce the existing economic inequalities.

Special Debate 55

CAN THE ECB DO MORE FOR EUROPE'S UNEMPLOYED?

Monetary policy and labour markets

Can the ECB do more for Europe's unemployed? With Basket-Eurobonds the ECB could act like the FED

■ **Peter Bofinger**, Professor for Monetary Policy and International Economics, University of Würzburg

This article puts forward the case for "basket Eurobonds". He argues that these will ease the pressure of crisis-hit states such as Greece and enhance the fluidity of the economic market within the Eurozone without succumbing to implicit government financing.

The Case for a Dual Mandate for the European Central Bank?

■ **Francesco Saraceno**, Senior Economist, OFCE, Paris

The author highlights the limitations of the current approach of the ECB to recover from the crisis. He argues the case for enhancing the dual mandate for the ECB to target specific areas to improve the situation overall whilst ensuring more accountability and overall improvement in the long-term.

The ECB and Unemployment

■ **Charles Wyplosz**, Professor of International Economics, Graduate Institute, Geneva

This article offers a critique of the ECB and its refusal to accept the significance of rising unemployment in Europe. Instead of assuming no responsibility on the matter a two-pillar strategy in relation to the monetary policy strategy is recommended.

Progressive Economy Highlights 73

- Upcoming Events
- PEAC Call for Papers 2013/2014
- Next edition

The **NEEDY**
Paying for the
SINS of
The **GREEDY**

Gov.
cuts
disabled people
We are
The Hardest Hit

STAY
HATE

Foreword



Hannes Swoboda,
MEP, Austria,
President of the S&D
Group in the European
Parliament



Stephen Hughes,
MEP, UK, Vice-
President of the
S&D Group in the
European Parliament

Europe's current misfortune is not just that it was hit by the most severe financial crisis in decades. It has also come from the fact that this crisis occurred during a time at which economic thinking was, and still remains, dominated by old concepts and neoclassical models.

Back in 2008 and 2009, survival instincts initially pushed even the most neoclassical politicians to support recovery plans of Keynesian inspiration. Unfortunately for Europe, those first instincts were quickly undermined by flawed forecasting models and the economic dogma that inspired them. In 2010, coinciding with the recovery of employment and output in Europe, policymakers and economic experts switched gears, abandoned the policies that were working and made a dramatic shift of policy towards austerity. The world was told that this would not provoke a new plunge in economic activity and a continuing explosion of unemployment. Their economic models, they said, showed that big cuts in public spending would restore investor confidence and pull us out of recession. As we now know, just the opposite happened. Unsurprisingly, recession is still present, confidence is low and unemployment and uncertainty continue to increase. It's the multiplier, stupid!

The fiscal multiplier scandal, finally unveiled by the IMF but to this day not properly acknowledged by the European Commission, has been buried by the Commission under a

mountain of confusion and discreet, superficial adjustments to the model, fighting shy of the fundamental revision that was needed. But the sorcerer's apprentices in the Commission may yet be made accountable for their tragic mistakes: the European Parliament has just launched an inquiry into the work of the Troika in the EU's "adjustment" countries - that is, those worst hit by the crisis.

Yet, neoclassical economics are not alone to be blamed. The crisis also painfully revealed the absence of influential alternative thinking from the worlds of science and of politics. It's not that there were no good ideas around. At least some leading economists managed to make their critical voices heard, such as Joseph Stiglitz or Jean-Paul Fitoussi, and promoted a different approach. Back in 2010, the S&D Group issued a policy paper which looks more prescient with each passing year of recession and stagnation. It attacked the shift from recovery to austerity, called for a less frantic pace of budget consolidation and insisted that essential investment should be ring-fenced - these are key demands in today's public debate. The S&D Group also fought a lonely battle against an extreme austerity-centred version of the "six-pack" legislation in 2011, the successor to the so-called stability pact which carved out a slightly more favourable policy environment for productive public investment.

But these were voices in the wilderness.

Things cannot go on in this way.

Progressives across society must reclaim the academic and public debates. To do that, a new, more intense and more sustained interaction between progressive politics, the academic world and key stakeholders - in particular the trade union movement - is needed.

Europe's current misfortune is not just that it was hit by the most severe financial crisis in decades. It has also come from the fact that this crisis occurred during a time at which economic thinking was, and still remains, dominated by old concepts and neoclassical models.

That is the cause for which Progressive Economy was launched.

The first Progressive Economy initiative was to support the production in November 2012 of a serious and credible alternative to the European Commission's so-called Annual Growth Survey. Because the AGS is the pivotal document within the annual European semester process, it was essential to break the Commission's unhealthy intellectual and political dominance of EU-wide macroeconomic analysis, forecasts and policy recommendations. That is the role of the so-called independent AGS (iAGS), which is now produced each year in November by three economic institutes, based in three EU member states - OFCE, IMK and ECLM¹.

Since then, Progressive Economy has developed new initiatives directed both towards the scientific community through its prestigious scientific board - notably with its current call for papers - and towards the political community, seeking to achieve a much better joint involvement of progressive European and national members of parliament within the European economic and social policy process. These initiatives should generate stimulating and enriching exchanges between those

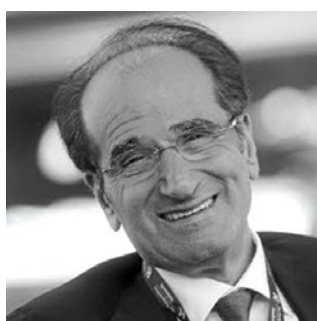
communities and with key stakeholders, notably through this quarterly Journal for a Progressive Economy, and through a series of events, whose focal point will be the Annual Forum of the Progressive Economy initiative in March.

One can only encourage progressive-minded people in Europe and beyond, who feel they have something to contribute to the re-emergence of a strong and inspiring progressive agenda in the economic and social fields, to join the efforts of this initiative in whatever way they can.

¹ Observatoire Français de Conjoncture Économique (OFCE), Paris, Institut für Makroökonomie und Konjunkturforschung (IMK), Düsseldorf, et Economic Council of the Labour Movement (ECLM), Copenhagen.



Europe: a child of the economy, an orphan of politics



Jean-Paul Fitoussi,
Professor of
Economics at the
Institut d'Etudes
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(Sciences-Po), Paris
and LUISS Guido
Carli University,
Rome.

Since 1997, he has been a member of the Council of Economic Analysis of the French Prime Minister and a member of the Economic Commission of the Nation.

As we move towards the future, the situation is bleak. The decisions made at successive European summits do not seem likely to address the structural defects of the Eurozone. The disappointment with the Europe of today is that it deals with a constitutional problem as if it were merely an economic one. The fiction of the sustainability of Europe, a child of the economy, but an orphan of politics, continues to undermine European integration.

It is certainly true that the proposed banking union shows real progress. But only part of the union's supervision has been defined, and it comes into force in 2014. Its other elements - the resolution of banking crises and deposit insurance - remain under national jurisdiction, and their European future is even more uncertain. There must be real solidarity, something which Europe lacks most of all.

We have the Growth Pact and the Treaty on Stability, Coordination, and Governance. To which future are they leading us?

As it was signed, the Growth Pact – investment projects financed primarily by existing structural funds and the European Investment Bank's increased capital (10 billion Euros) – is not likely to transform activity in the Eurozone. We are talking about 120 billion Euros; even this is mobilising funds which have not yet been used, to enable the EIB to lend 60 billion Euros by leveraging its capital increase. Whether or not a start has been made is a mystery. This is why the European recovery seems more symbolic than real, a remake of the addition (fiercely negotiated in 1997) of the words "and growth" to the Stability Pact. Because, at the moment, EU regulations and conditions for assistance to countries considered fragile have plunged these countries into depression and have delayed Eurozone recovery.

Have we really helped Greece, given that its GDP is currently more than 20% lower than it was on the 1st January 2008?

It is difficult not to view the Growth Pact as the soothing balm applied to smooth the roughness of the "fiscal compact." Therefore, we have a treaty which establishes the fiscal solitude of each of the Eurozone member states through a promise of greater solidarity if they show themselves to be capable of solving their own problems. It forces, or rather, it requires states to self-impose sanctions or risk facing penalties, to have fiscal rules that are found in no other democracy in the world. In fact, it aggravates the European democratic deficit, making member states even more federal, and, at the same time, even more the orphans of a federation.

Rules and choice revisited

Since the end of World War II, economists have been debating the question of whether to emphasise rules or discretion in economic policy. In the forties, Milton Friedman had already advocated adopting monetary rules and suggested enshrining balanced fiscal rules in the constitution. But it was the "revolution" of rational expectations and the neo-classical school which established in a "definitive" way the superiority of rules over choice². Much attention was given to this conclusion, which inspired monetary policy management in many countries. But no country gave up its fiscal sovereignty, or indeed its monetary sovereignty, since in all countries (except in Europe) central banks are accountable to national parliaments. The neo-classical school's demonstration would only apply to a world without imbalance, where economic policy resembled Don Quixote's fight.

¹F.E. Kydland & E. Prescott (1977) : « Rules rather than discretion: the inconsistency of optimal plans », Journal of political economy, Vol. 85, n°3. et R.E. Lucas (1981) : « Rules, discretion and the role of the economic advisor », in R.E. Lucas : Studies in Business cycle Theory, The MIT Press.

But how was Europe, probably without knowing it, able to endorse such a doctrine?

The reason is that adopting this doctrine binds governments' hands so strongly it prevents them from acting, even in circumstances like today where inaction is irresponsible. Social suffering worsens, unemployment soars, recession threatens the Eurozone and depression takes hold in many countries. Can we then do nothing to fight against these ills and against budget deficit reduction as the sole macroeconomic policy?

It is true that distrust of democracy occasionally leads to fiscal virtue in some countries. In 2011 in the United States, for example, the Republicans tried to pass a constitutional regulation in Congress to have a balanced budget. But great voices were heard and the attempt failed.

In a letter addressed to President Obama, the President of Congress, leaders of minorities and majorities in the House of Representatives and the Senate, with eight of the greatest economists of our time³, urged Congress to reject the amendment to introduce into the constitution a balanced budget clause. Their arguments are very widely shared by the economic community. The principles are worth returning to.

1. Preventing automatic stabilisers from working aggravates recessions.
2. It is legitimate, as it is for other economic actors, to allow the state to finance investment expenditure by borrowing and thus have a budget deficit.

3. Such an amendment would encourage Congress to pass on to local authorities (who do not have the means) the finance expenditure that it is not in a position to take on. It will also prompt creative accounting with the selling of, for example, public assets. It will be left to judges to interpret the country's fiscal situation, which could lead to an economic policy defined by the courts.
4. Nowadays, it is dangerous to try to balance the budget too quickly. The very substantial spending cuts or tax increases that would be required would be very detrimental to a recovery which is still uncertain.

These arguments are good theory and can also be applied to the Treaty on Stability, Coordination and Governance.

All the arguments put forward by the American economists in their letter to President Obama apply to European rules. Of course it could be said that the treaty looks at the structural deficit and not the nominal deficit and, therefore, does not prevent the automatic stabilisers from working. But as it requires member states to define and apply a convergence path from now on, and furthermore it forces countries to reduce by one-twentieth per year the gap between their actual debt and that tolerated by the Stability Pact (60% of GDP), it at least partially blocks the automatic stabilisers. This is another way of saying that it obliges countries to bring forward, taking into account the current situation, a procyclical policy which is restrictive in a period of recession.



³ Kenneth Arrow (Nobel prize), Allan Blinder (Former Vice-President of the Fed), Peter Diamond (Nobel prize), Eric Maskin (Nobel prize), William Sharpe (Nobel prize), Robert Solow (Nobel prize), Charles Schultze (Former President of the Council of Economic Advisors) and Laura Tyson (Former President of the Council of Economic Advisors).
<http://www.cbpp.org/cms/index.cfm?fa=view&id=3543>

Fortunately, this time, the circle of madness is limited to Europe. Other parts of the world seem to have learned the lessons of the Great Depression of the thirties.

It puts the Court of Justice at the centre of the measures, as the economists mentioned above feared it would. Furthermore it stipulates that member states establish an independent national institution to monitor the Treaty's enforcement. Lastly, it requires countries with deficits considered to be excessive to implement a "partnership" programme under the supervision of the European institutions. There is evidence of a reduction in the fiscal role of parliament, which is putting democracy under technocratic guardianship. Instead of being under the guardianship of an unquestionably legitimate federal state, they are put under the control of independent institutions with weak democratic legitimacy.

In the absence of an agreement to "fix" the European Constitution – making the ECB a fully functional central bank, pooling debt to make market arbitration impossible, just as the single currency (the pooling of currencies) put an end to speculation on intra-European exchange rates. European states are also obliged, under the current Treaties, to reduce debt. This is where fears of a long European recession find their roots.

Are we doomed to repeat the same mistakes? In 1929, the day after the crisis, the British government published a white paper, known as the *Treasury view*,

to essentially say that public investment policy would have no effect except to damage the state finances, and that overall maintaining a balanced budget was the wisest policy. This doctrine was applied not only in England but also in Germany and the United States (until the New Deal). So the question up for debate focused on ways to combat unemployment and public investment that were advocated by some economists. Richard Kahn, before Keynes, invented the concept of the employment multiplier³. But the *Treasury view* said that the increase in public spending could affect neither activity nor employment. The theory was based on the crowding-out effect: such an increase would result in a decrease of equal magnitude in private spending, so that domestic production could not increase. This tipping effect assumes that there is either a physical limit to production increases – production capacity would be saturated – or higher public investment would lead to an increase in interest rates⁴ which discourages private investment. This theory is based on Say's law, known as the law of markets⁵: "supply creates its own demand." In other words, there would be no problem with the markets, and it would be futile to try to increase the demand to revive the economy. Only action at the supply level would

³ "The Relation of Home Investment to Unemployment", 1931, *Economic Journal*.

⁴ The state has to borrow to finance investment, the demand for credit increases and therefore so too do interest rates.

⁵ Or at least a simplistic interpretation of this law, see Robert W. Clower: "Trashing J.B. Say: The Story of a Mare's Nest" in K. Vela Velupillai: *Macroeconomic Theory and Economic Policy*, Essays in honour of Jean-Paul Fitoussi, Routledge, 2004.

lead to such a result. It is understood that Keynes made this law his worst enemy. But we can understand why the Treasury view precipitated depression because we know what happened.

Eight decades later, Europe has the same opinion – not only that salvation will not come from a public investment push, but also that public spending should be reduced and taxes increased to create conditions for future recovery. So much for global demand! Instead it is a policy of supply that must be pushed forward. The hullabaloo over the issue of competitiveness originates from this decree. The Gallois report in France, and the competitiveness plan that ensued, demonstrate this. The competitive shock from which a miracle is expected results in transferring, say, twenty billion euros from households to firms. The purchasing power of the former and the labour costs of the latter will be reduced accordingly. French companies would thus become more competitive, but it is not the (flagging) French demand from which they can expect extra markets, but foreign demand, especially European. Yet the internal demands of other European countries are sluggish, as they all pursue the same policy with everyone looking to increase their competitiveness. The surest outcome of these overlapping strategies is a collapse in demand, and yet these are the only strategies authorised by the European rules. What can a government forced to cut its spending and raise taxes (without devaluing its currency) usefully do to boost growth? We find, in this context, the same ingredients that led to the deepening of the Great Depression of the thirties: competitive

devaluation first, then trade wars and protectionism. There is a strange similarity between *the treasury view* back then and the doctrine that led to the fiscal compact of today.

Fortunately, this time, the circle of madness is limited to Europe. Other parts of the world seem to have learned the lessons of the Great Depression of the thirties. It is fortunate too that the power of conventional ideas seems to involve more than just fiscal policy. Central banks have learned a lot and are ready to drive forward the most heterodox strategies to safeguard the future. But will the European treaties leave the ECB alone? And will governments resign themselves to a lost decade of growth, more than half of which has already passed? ■

As we move towards the future, the situation is bleak. The decisions made at successive European summits do not seem likely to address the structural defects of the Eurozone. The disappointment with the Europe of today is that it deals with a constitutional problem as if it were merely an economic one. The fiction of the sustainability of Europe, a child of the economy, but an orphan of politics, continues to undermine European integration.

Europe:

In need of an alternative to neoliberalism



Stefano Fassina,
Deputy Minister of
the Italian Ministry
of Economic and
Financial Affairs.

From 2009 to 2013 he was head of the Economics and Labor Department of the Italian Democratic Party. He previously served as economist at the IMF and as economic advisor in various national and international institutions.

Almost six years after the outbreak of the subprime crisis, the US economy is growing at a timid pace whilst the European economy is still experiencing the worst days since World War 2. The Eurozone, in particular, finds itself stuck in a double-dip recession that is seriously jeopardising the well-being of millions of people.

Why is a crisis which originated elsewhere devastating Europe?

The answer to this question lies in a flawed economic paradigm that has dominated the scene for the last thirty years. It determined, in turn, a flawed institutional design for the Eurozone and consequently flawed policy choices.

First of all, that economic paradigm had a major part to play in creating suitable economic conditions for the downturn: the blind faith in market freedom – strong deregulation of labour and financial markets, trade and capital flows, which generated a serious weakening of workers' bargaining power and governments' (redistributive) intervention. As a result, we had three decades of ever-widening inequality, albeit hidden in terms of negative effects on growth by the huge increase in private debt. The subprime crisis can be identified as an alarm bell for the long term unsustainability of this path.

In addition to that – and more importantly, in the Eurozone crisis – the same economic paradigm had the fundamental role of leading a willful misinterpretation of the crisis itself. What is clearly a foreign/private debt-balance of payments crisis has been passed off as a public debt crisis, due to governments' profligacy in

the southern Eurozone member states. This interpretation is at odds with the data: with the exception of Greece, with the "methodological issues" on its fiscal reports, in 2007 all the PIIGS had sound or improving public finances. Italian gross public debt was 108.5% of GDP in 2000 and 103.3% in 2007 (132.3% today!); in Portugal it increased in the first half of the 2000s, but it was still around 65% of GDP before the crisis; Spanish public debt was 36.3% in 2007 (59.4% in 2000, 93.7% in 2013); in Ireland it was less than 25% of GDP in 2007 (123.3% in 2013). On average, these countries were running remarkable primary surpluses in 2000-2007, whereas Germany registered five consecutive years of primary deficits in 2001-2005.

Actually, in the years preceding the crisis the PIIGS have in common a rapid and alarming worsening in their international investment position, due to the accumulation of large current account deficits almost entirely financed by northern countries. In other words, since the creation of the Eurozone the peripheral countries reduced but did not eliminate inflation differentials with respect to the core countries, owing to major structural heterogeneity and to the lack of a true economic and institutional convergence policy within the Eurozone. Moreover, the strong wage compression seen in Germany in the last decade worsened the terms of trade for the southern countries. As a result, in 2007 Germany had a 7.5% of GDP current account surplus; in the same year all the PIIGS had a current account deficit (from the -1.3% of Italy to the -14.6% of Greece). These figures were not so different in the previous decade. To make ends meet, capital flows from the core to the periphery were financing the current

account imbalances, producing huge profits for surplus countries and huge amounts of external debt for the deficit countries. The Eurozone was an unsustainable transfer union. The “saints” depended on the “sinners”.

When the US financial crash happened, the global capital market freeze caused financing for the Eurozone’s imbalances to suddenly stop. Rescue mechanisms paid out of public balance sheets (in particular to save core countries’ banks) were necessary to avoid a European banking disaster; the sharp recession that followed the financial turmoil and the automatic stabilisers’ activation caused further deterioration in the fiscal position of the peripheral countries: a private debt crisis – essentially due to a deeply unequal redistribution process from wages to profits – has eventually become a public debt crisis.

The neoliberal thinking which permeates the European institutions has accused the southern countries of fiscal irresponsibility and has imposed a completely asymmetric adjustment path: harsh austerity both in public and private sector, with sharp internal devaluation to improve competitiveness vis-à-vis the core countries. Without the implicit guarantee of unconditional intra-area fiscal transfers, without a central bank acting as lender of last resort and without a well-functioning banking system, it was clear that the joint deleveraging of public and private sector would have induced a severe recession.

Influential European officials and political leaders, unfortunately not only in the conservative camp, recently disclosed some sense of satisfaction for the latest macroeconomic data: from a technical point of view, the recession is over and, thanks to wage devaluation, current account balances are

consequently improving. The picture looks good only because it is dramatically incomplete. It ignores the fact that the average public debt in the Eurozone has jumped by 30% of GDP (from 65% in 2007 to 95% in 2013). After six years of huge social and economic costs (in Italy and Ireland, the total unemployment rate is higher than 12%; in Greece and in Spain it is well above 25%, while the youth unemployment rate is well above 50% and IMF estimates similar figures until 2017-2018), the overarching fiscal objectives are a long way from being achieved and, considering the medium-term economic outlook, public debt is becoming unsustainable in several Eurozone countries. In short, fiscal austerity is self-destructive.

In spite of this, the European Commission’s policy recommendations still have the same focus: to further “structural reforms” (enhancing labour market flexibility, reducing government size and the welfare state, etc) and fiscal consolidation. It is by no means clear that exactly this policy approach lies at the heart of the crisis. Nor is it considered, for instance, that in Germany, the real GDP growth rate is near to zero in 2013, yet it is predicted to remain very low for a long time (1.2%, on average, in 2014-2018). The data shows that relying on external demand – squeezing internal demand via wage compression and government spending cuts – is not possible for all Eurozone members at the same time: in a highly-integrated free-trade area, there is an easily foreseeable fallacy of composition; it enlarges the open-economy fiscal multipliers’ values (hence the underestimated negative impact of simultaneous austerity programs). This is all the more true looking at the rapidly declining emerging counties’ growth rates.



“A private debt crisis – essentially due to a deeply unequal redistribution process from wages to profits – has eventually become a public debt crisis.”

In the short run, some important policy changes are necessary: as the IMF suggests in its latest World Economic Outlook (October 2013), in the peripheral countries *“the pace of adjustment has to drop off”* and the ECB should provide *“additional monetary support, through lower policy rates, forward guidance on future rates (including long-term refinancing operations at fixed rates), negative deposit rates, or other unconventional policy measures”*. In the meantime, a minimum requirement would be for the core countries to favour wage growth and reflation (taking on an expansive fiscal stance), to strengthen internal demand and to meet halfway with peripheral countries, while a golden rule should be agreed for funding productive investments authorised by the European Commission.

But much more is needed. A fully-fledged banking union has to be completed, Euro-project bonds must be launched to fund trans-European networks and social and environmental standards should be set for trade and capital flows.

The social and economic success of the European Union as a whole requires a cultural and theoretical alternative to neoliberalism. Only on a renewed ideological basis can the European integration process go further. Otherwise, “Titanic Europe” hits the iceberg of nationalism. ■



How Should the EU Exit the Crisis?



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Four years into an unprecedented financial and economic crisis, Europe is at a critical juncture. Economic activity is practically stagnant. The EU-27 unemployment rate has exceeded 10 percent. Inequality and poverty rates are increasing to record levels.

Europe is becoming rapidly segmented. A sharp divide is developing between surplus countries in the North and deficit countries in the South. In the North, unemployment remains low and social safety nets virtually intact. In the South, social systems are crumbling and large segments of the population are becoming marginalised. One out of two young Greeks or Spaniards are unemployed with the overall unemployment rate climbing to 30%. More than 400,000 families with children in Greece try to make ends meet with no single employed adult in the family. Sharp declines in personal after-tax disposable income or pensions have made middle class families in Portugal, Spain and Greece unable to pay debts and mortgages. They are becoming rapidly over-indebted if not impoverished. A growing number of young professionals are seeking employment abroad, in Germany, the UK and other European countries.

Confidence in the capacity of national governments, traditional political parties and European institutions to pursue credible policies so as to improve standards of living has been seriously eroded. Xenophobia and Euroscepticism are on the rise throughout Europe. In the South, austerity policies are perceived as unjust, ineffective or as having been imposed to serve creditors at the expense of the most vulnerable groups in society. In the North, most notably in Hungary, the Netherlands, Finland, Austria, France and

Denmark, domestic residents are made to believe that they are paying a high bill to bail-out their profligate European Southern co-members, while they themselves have to cope with worsening economic conditions. According to the May 2013 IPSOS/CGI opinion, three out of four Europeans believe that the economic crisis will worsen in their own country; they view European institutions as incapable of reversing the trend and narrowing the growing divide between North and South.

Can the EU exit from this economic, political and social crisis? The answer is positive provided that the source of the European crisis is correctly diagnosed and appropriate measures and initiatives are taken to provide the appropriate cures.

The Diagnosis

The origins of the European crisis have been extensively analyzed by many authors. The subprime mortgage bond debacle that exploded in the United States in 2007 rapidly spread to Europe’s financial and banking sectors. Like their US counterparts, big international European banks, virtually unregulated and convinced that they would be bailed out by national governments if needed, had proceeded to extend cheap credit to sovereigns, local governments and the private sector, covering their potential risks via derivatives and/or the securitisation of loans. As documented by Lewis (2011) and others, hedge fund managers and speculators soon detected that European sovereigns, namely Greece, Ireland, Italy, Portugal and Spain, would be unable to avoid default or rescue their banks through new borrowing if attacked; amassed debts exceeded by large margins their projected

tax revenues. A potential sovereign bond crisis would also rock the euro and the Eurozone. By the end of 2008, the market for government default insurance and credit default swaps started booming and speculation against the euro intensified.

Greece was the first to be attacked at the end of 2009. Its downgrading by rating agencies in November and December 2009 brought about an unprecedented rise in spreads, which eventually shut the country off from international markets and forced it to seek its first rescue package in May 2010. In the meantime, between 2008 and 2011, Greek credit default swaps were up from 11 basis points to 2300! Every \$1,100 bet made in 2008 returned \$700,000 in a few years (Lewis, 2011, p xiv) bringing about huge profits to market participants.

The unprecedented fiscal consolidation and austerity package agreed upon between Greece and its creditors in three successive Memoranda of Understanding in exchange for €240 billion in loans plunged the economy into a deep recession. The financial crisis produced a domestic liquidity crisis making households and firms unable to obtain credit. The credit crunch, in conjunction with the dramatic fall in disposable incomes, made them unable to pay back their obligations. The unsustainable Greek sovereign debt crisis was thus converted into a domestic banking crisis.

In Ireland, it was the Irish banks which were the culprits. They had proceeded to lend astronomical sums of money – approximately €106 billion according to some estimates (Lewis, 2011, p.85) - to property developers. The ensuing real estate bubble burst in 2008. The government's decision to guarantee all debts of the affected banks brought about

huge increases in the budget deficit and the collapse of an entire economy. The Irish bank debt was converted into Irish government debt. The domestic liquidity crisis that ensued, exacerbated by imposed austerity policies, brought about a severe recession and aggravated the overall debt problem.

Similar processes have characterised developments in Spain, Portugal, Italy, Cyprus and other European member states. Over-indebtedness, public or private in nature, spurred on by an unregulated financial sector and the illusion of "implicit guarantees" and a risk-free Eurozone, triggered confidence crises in asset markets and speculative attacks in sovereign bond markets; in view of the no- bailout clauses of the ECB Charter and the Lisbon Treaty, these led to large bail-out programs of European sovereigns through the newly created European Stability Facility Fund (EFSF) and subsequently through the permanent European Stability Mechanism (ESM) in exchange for severe austerity and budget consolidation programs. The results have been devastating for large segments of European society.

Influential European officials and political leaders, unfortunately not only in the conservative camp, recently disclosed some sense of satisfaction for the latest macroeconomic data: from a technical point of view, the recession is over and, thanks to wage devaluation, current account balances are consequently improving. The picture looks good only because it is dramatically incomplete. It ignores the fact that the average public debt in the Eurozone has jumped by 30% of GDP (from 65% in 2007 to 95% in 2013). After six years of huge social and economic costs (in Italy and Ireland, the total unemployment rate is higher



than 12%; in Greece and in Spain it is well above 25%, while the youth unemployment rate is well above 50% and IMF estimates similar figures until 2017-2018), the overarching fiscal objectives are a long way from being achieved and, considering the medium-term economic outlook, public debt is becoming unsustainable in several Eurozone countries. In short, fiscal austerity is self-destructive.

In spite of this, the European Commission's policy recommendations still have the same focus: to further "structural reforms" (enhancing labour market flexibility, reducing government size and the welfare state, etc) and fiscal consolidation. It is by no means clear that exactly this policy approach lies at the heart of the crisis. Nor is it considered, for instance, that in Germany, the real GDP growth rate is near to zero in 2013, yet it is predicted to remain very low for a long time (1.2%, on average, in 2014-2018). The data shows that relying on external demand – squeezing internal demand via wage compression and government spending cuts – is not possible for all Eurozone members at the same time: in a highly-integrated free-trade area, there is an easily foreseeable fallacy of composition; it enlarges the open-economy fiscal multipliers' values (hence the underestimated negative impact of simultaneous austerity programs). This is all the more true looking at the rapidly declining emerging countries' growth rates.

The Outcome

Tables 1 and 2 present the salient features of the main countries at risk between 2008 and 2012.

Official debt to GDP ratios have increased in all countries overshooting projections by a large margin; despite the severe fiscal consolidation programs, public deficit to GDP ratios have either remained unchanged (Ireland, Greece) or have sharply increased (Portugal, Spain). Financial sectors have become increasingly vulnerable as a consequence of sovereign debt distress, liquidity shortages, capital flight and rising non-performing loans. Gross fixed capital formation has dropped by more than ten percentage points in almost all countries, with the exception of Portugal where the drop has been in the order of 8%. Growth rates are negative in all countries, except Ireland, and unemployment rates have soared. The massive decline in domestic demand, including investment demand, has resulted in temporary improvements in current account balances which, however, will not be sustainable if and when growth resumes. Overall price competitiveness has in fact deteriorated. Despite massive cuts in wages, energy cost hikes, combined with tax increases and productivity declines have contributed to appreciating real effective exchange rates. Last but not least, large segments of European society cannot make ends meet with poverty and inequality rising at unprecedented rates. In summary, the effects of the imposed programmes have been disastrous.



Table 1: Main economic features: Italy, Portugal, Spain, Ireland, Greece, EU (2008)

[illegible]**Table 2: Main economic features: Italy, Portugal, Spain, Ireland, Greece, EU (2012)**[illegible]

The Cure

There has been a realisation that policy failures have crumbled economies and societies alike, and the diagnosis provided above points to the appropriate cure to recover from the crisis.

What is required is an overhaul of policies and the pursuit of institutional changes that would jointly address the debt overhang problem, the investment slump, the liquidity squeeze and the social crisis. Unless the extreme austerity policies are reversed as soon as possible, there is a great risk that the Eurozone will crumble, the European project will be discredited and stalled and Europe will be severely weakened as a global power.

The Eurozone must cease to behave as a club of creditors. A testimony to that assertion is the Greek program. Between 2010 and 2013, Greece has borrowed from the Troika €219.2 billion. More than 97% of this funding has been used to pay back creditors and to cover recapitalisation needs. The imposition of non-concessionary interest rates on official debt has exacerbated the debt dynamics. Less than €8 billion over four years have been used to support pressing domestic budget needs or channel liquidity to a starving market. More importantly, all funds from a primary budget surplus or privatisations need to be deposited in an escrow deposit account at the Bank of Greece to service future debt payments while legal provisions embedded in the loan agreements stipulate that, in case of inability to pay, creditors can seize national public assets.

The Eurozone needs instead to become a steward of decent livelihoods, growth, jobs

and enhanced opportunities for the younger generation

What should be the elements of a progressive agenda for Europe and the Eurozone to exit the crisis? A three-pronged strategy is urgently needed:

a) Strengthening Mutual Adjustment, Banking Supervision and Solidarity

Exiting the crisis requires the pursuit of more symmetric macro-economic adjustment rules across surplus and deficit countries to correct major imbalances in the context of an enhanced stability pact. It also requires new financial instruments to mutualise risks and promote needed investments including a European Guarantee Facility, a Eurobond, or EIB-guaranteed development bonds. Timely action and institutional initiatives are needed so that markets are convinced that the ECB or the ESM will intervene effectively in times of speculative attacks to safeguard financial stability without lengthy political processes or politically-motivated delays. It took the combined statement by the Governor of the ECB that he "will do whatever it takes to save the euro" and the announcement that the ECB was ready to undertake Outright Monetary Transactions (OMT) - namely that it would intervene without any limit in sovereign debt markets subject to the conditions imposed to a country under stress - to calm the markets. Had the European Central Bank sent a similar signal to investors and speculators who were shorting Greek bonds in 2010, access to the markets could have been maintained and the costs of the crisis would have been mitigated.

Moreover, decoupling is necessary between the need for funds of national banking systems and domestic public finance. Banks that face a significant deterioration in their financial positions have to cease transferring the burden onto taxpayers. The June 2013 directive establishing a range of instruments to tackle potential bank crises, including bail-out clauses, was a step in the right direction. It might prove inadequate however, if a bank is considered “too large to fail” and contagion risks are involved. In such a case, turning a Bank directly over to the ESM so that the ESM itself and not the national government would proceed with full recapitalisation and prompt resolution would “break the deadly embrace between insolvent national banking systems and insolvent member-states” (Varoufakis et al. 2013). Such a measure should not await the completion of a banking union which will take time to be implemented.

Finally, an effective oversight of the European banking system is urgently needed in order to safeguard transparency, competition and ethical banking practices. The massive concentration of resources and power in the hands of large international banks which operate with minimal regulation has become fertile ground for toxic financial products, inappropriate lending, extractive practices, corruption and successive crises. Tax audits for bank managers, regular reporting of bonuses and monitoring of lending practices for consumer protection are important components of a more effective regulatory framework. This was the central message of the 1998 CDP report (UN, 1998) which advocated the creation of a World Financial Organisation to set uniform rules of conduct for financial transactions.

b) Addressing the Debt Overhang and Securing Financing for Sustainable Development

Exiting the crisis in a sustainable manner requires addressing the debt overhang, the domestic liquidity shortage and the investment slump in an effective manner.

Debt sustainability is a precondition for investment and growth. A large debt overhang dissuades potential investors, perpetuates financial instability and stalls growth. When debt is judged to no longer be serviceable, as is the case in Greece and maybe Portugal today, debt restructuring is urgently needed. Postponing the decision only exacerbates the debt dynamics and deepens the recession as proven by recent experience. By refusing to engage in timely debt restructuring in either 2010 or most of 2011, European leaders sheltered European banks against potential losses from their large exposures in Southern European sovereign debt which they then rapidly proceeded to divest; in so doing they transferred large costs to European wage earners, pensioners, individual bond holders and taxpayers. The same costly inertia is present today, as official creditors refuse to admit the need for official debt restructuring, despite the IMF announcements to the contrary.

Apart from debt restructuring, access to adequate and reasonably priced credit by viable firms, especially SMEs, needs to be urgently restored. Under present conditions, it will take a long time before liquidity is channelled to households and SMEs through the stressed national banking systems. Public action involving



the creation of independent recyclable-loan vehicles, funded by a combination of official and private resources and/or supported with guarantees issued by European institutions (e.g. KfW or the European Investment Fund) would mitigate the recessionary impact of the liquidity shortage. The presence of strong cooperative or public development banks can be similarly proven valuable in promoting competition, the channelling of liquidity to the real economy and adequate project and development financing.

Finally, effective resource management to attain realistic primary surpluses would facilitate the resumption of investment and growth. This is not only a national but also a European priority: the existence of unregulated tax havens and offshore platforms, the lack of European-wide agreements on disclosure and tax treatment vis-à-vis non-European member states such as Switzerland, the systematic overpricing and underpricing of intra-company transactions for tax advantages, all promote capital flight and tax evasion. These problems require European collective action to complement much needed domestic structural reforms in taxation, public administration, governance and regulatory systems.

c) Reversing Austerity, Providing Social Safety Nets and Promoting Policy Coherence for Competitiveness and Jobs

In the presence of globalised markets, European competitiveness cannot be enhanced on the basis of drastic wage and asset-price reductions, rising unemployment and sharp declines in purchasing power. On the one hand,

developing countries and even many emerging economies are in a better position to reap low labour-cost competitive advantages than European countries. On the other hand, severe austerity measures and internal devaluations end up producing opposite results: the drastic reduction of disposable incomes and the massive closure of firms result in growing inability by households and firms to pay taxes, social security contributions or bank debts and mortgages with negative effects on budgets, debt and productivity.

In the long-run therefore, Europe's competitiveness can be enhanced only through productivity-enhancing investments, R&D and continuous innovation. These are the drivers that would make Europe a preferred destination for global enterprises, an exporter of high value-added products and services and a provider of high-quality jobs. The implementation of such a progressive vision requires the pursuit of far-sighted and carefully planned structural reforms to open up markets and reduce the administrative cost of doing business as well as public-sector, educational and/or labour market reforms depending on country needs. It also requires a fair tax system, a growing public investment budget and accountable, transparent governance systems. Finally, in the presence of fiscal consolidation programs, such reforms need to be complemented by coherent policies to secure decent livelihoods through active employment policies, the orderly restructuring of outstanding loans, low-cost access to health systems and the extension of carefully designed social benefits.

In summary, for the EU to exit the crisis, current austerity policies need to be reversed. They end up undermining not only the fiscal consolidation process and competitiveness but also social cohesion and democracy.

A progressive alternative agenda for a competitive and cohesive Europe that places decent livelihoods, jobs and democracy as top priorities does exist. What does not exist as yet is a collective determination to mobilise social and political progressive forces across countries and stakeholders to build a European Progressive Front for Decent Jobs and Livelihoods. This is the present day challenge for all progressive Europeans. ■

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The massive concentration of resources and power in the hands of large international banks which operate with minimal regulation has become fertile ground for toxic financial products, inappropriate lending, extractive practices, corruption and successive crises.



Progressive labour markets - an old and a new battlefield



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Progressives need to build a new and convincing case for labour markets that are both inclusive and competitive

During the early 1990s, Denmark and Sweden became, under social democrat led governments, the most advanced laboratories for a new and dynamic approach to labour markets. By redefining the very notion of job security in a globalising and rapidly changing world, their governments managed to effect a historic shift on labour market rules and public policies, while remaining faithful to their social democratic values. They achieved this in close partnership with trade unions. The result was a huge drop in unemployment levels and a strong boost to national economic performance.

As early as the mid-1990s, the new Danish and Swedish approach was picked up in Brussels, to become the new backbone of the European employment strategy, largely thanks to the former Swedish Minister of finance Allan Larsson, who had become director general of the Commission's DG for employment and social affairs (1995-2000). At the end of the decade, at a time of social democrat dominance in the EU's Council of Ministers, the same thinking helped inspire the now defunct Lisbon strategy, launched in 2000. In retrospect, these were the good times...

However, a shift of political power in Europe towards the right and - partly in consequence - the failure to properly implement the Lisbon strategy at national

level ushered in a change of discourse on how labour markets should function and how public authorities should fight unemployment.

This change of direction, led by the European Commission under the label of "structural reform", has become most apparent in the midst of the crisis - above all in those countries that are most severely hit. This is the more surprising, since the labour market deregulation agenda which the Commission has embraced was abandoned by the OECD in 2006⁷. The Commission's persistence with this agenda becomes shocking in the light of the accumulation of evidence in recent years that labour market deregulation has at best a weak and uncertain correlation with levels of job creation⁸. Today's frontal assault on labour market rules, on collective bargaining practices and on wage levels of peripheral and southern Member States, contrast dramatically with the progressive employment agenda that emerged twenty years ago in the Nordic member states.

This article is not intended as a nostalgic attempt to relive the 1990s. These reforms must be our inspiration, but cannot provide all the answers. Since then, global competition has increased; millions of jobs have been outsourced, many permanently; we have seen a full-scale financial crisis, an unsustainable growth model built on private debt, a hollowing out of the middle class; and rigid labour markets have been replaced with precariousness and a brutalisation of the labour market. Our vision of progressive labour markets must reflect this new reality.



⁷ OECD, Boosting jobs and incomes - policy lessons from re-assessing the OECD Jobs Strategy, 2006.

⁸ Avdagic S. and Salardi P (2013) Tenuous link: labour market institutions and unemployment in advanced and new market economies; Socio-economic Review

Let's be offensive

It is time for Europe's leaders to stop scapegoating workers and employees for the failures of governments and EU institutions to tackle unemployment. Europe will not pull itself out of crisis by pushing hard-working people towards poverty and insecurity. The fruits of the current ideologically driven policies of this conservative-led Europe can be found in social and political instability, which lead to further economic decline. The European Commission is wedded to non-remedies, at odds with all the evidence, while unemployment continues to rise in much of Europe, and long term and youth unemployment are at record highs.

To counter this socially and economically destructive agenda, progressives need to unite around a clear alternative path to high quality and full employment. This is especially timely now, in the run-up to the next European elections. To contribute to this fight, Progressive Economy has launched a reflection process on this very theme, while the S&D Group is currently conducting work on a jobs initiative, designed to update and sharpen its position on employment and labour market issues, and to stimulate a wider debate on the role Europe can play in the creation of more and better jobs.

It is possible to create policies that fit today's challenges, whilst respecting fundamental values like the protection of workers, solidarity, equal pay, equal rights and the welfare state. That's why we have pushed so hard for the youth guarantee, for example - a measure which needs to reflect these principles if it is truly to meet the very modern challenge of combating notably youth unemployment.

So, what are progressive labour markets?

In the first place it's not enough to create just any jobs - they must be decent jobs - a primary concern for those who have been ghettoised in low-paid, low-skilled jobs with little scope for advancement. That is why social democrat employment and social affairs ministers are collectively calling for a European framework regulation for living wages, which would ensure that in every EU member state, full-time workers will get a wage above the poverty line, fixed either through collective bargaining or by law. As pointed out by the American Nobel-winning economist, professor Joseph Stiglitz, ensuring decent wages is not only important for social cohesion and fairness in society, it is also important for maintaining a strong economy. The systematic hollowing out of middle-class wages that we have seen in the Western societies over the last decades will result in declining demand and growth. A central condition to sustained growth is therefore to ensure European workers living wages and by that, substantial purchasing power.

Job quality is essential in a knowledge-intensive economy. High labour productivity and rapid innovation rely on a skilled, adaptable, committed workforce, with decent health and safety standards, a sense of security and reasonable working time. These goals, which will be the lynchpin of economic success, are also essential goals for the well-being of our society.

Progressive labour markets will also be marked by a stronger role for collective bargaining and tripartite arrangements.

Internal flexibility, negotiated between social partners, has been an underlying source of Germany's resilience in the crisis. We shall need social dialogue at European, national and local levels to implement the youth guarantee and to develop dual education systems. Public authorities have a role to play, to trigger and steer tripartite social dialogue, and to uphold the agreements reached by the social partners.

But progressive labour market policy is also about the demand side. As underlined by the former Portuguese labour minister Maria João Rodrigues, "it is not enough to activate labour supply, it is necessary to activate labour demand"⁹. Policies to address the skills mismatch should not only focus on retraining workers and reforming education systems. They also need to work on improving job quality, create a stimulating work environment, and foster lifelong learning and work-based training¹⁰. Re-skilling should be encouraged, for example, through cost-sharing arrangements for training and through public policies for the recognition of non-formal and informal skills. But not all unemployed people need training: often, the missing ingredient is individualised career guidance and counselling, particularly for the long-term unemployed. That requires investment in well-trained staff in public employment services, and in profiling techniques to build on each individual's strengths¹¹.

Active labour market policies should be complemented by a real banking Union, which allows investment capacity to be restored and which fully takes on board job creation capacity. Equally, this should be complemented by an industrial strategy to stimulate job creation through smart specialisation, promotion of new innovative sectors and the

transition to a greener and more sustainable economy. So a progressive labour market requires a coherent policy mix, combining macroeconomic policies and structural policies. Solid labour market institutions - un-segmented labour markets, coordination of collective bargaining and well-resourced welfare systems (which work as automatic stabilisers) - have proven essential in absorbing cyclical shocks.

Structural reforms will be needed to reinforce labour market institutions in the member states most hit by the crisis, but it will take time before they bear fruit, so it is vital to use macroeconomic policy to ease their implementation. And instead of treating institutional reforms in isolation, they have to be made coherent. For instance, the Commission - basing itself on a distorted and denatured version of Denmark's "flexicurity" model of the labour market - has often pressed for lower levels of employment protection. But it ignores the importance of well-designed employment protection. For instance, longer notice periods can make labour markets more efficient by helping workers to anticipate the transition. And other key elements of the Danish system are equally cold-shouldered - generous unemployment benefits, active labour market policies, provision of leave for training.

A progressive labour market policy requires a rethinking of the Commission's cheapened and degraded version of flexicurity, to put in place a coherent employment policy for adaptability and security. We need genuine structural reforms, not the destruction which the Commission mislabel as "structural reform". We need real reforms which reform society, which reform labour markets whilst enhancing fairness and real chances for all.



⁹ Maria João Rodrigues, "How can Europe create jobs?" Note for the European Parliament's Special Committee on the Financial, Economic and Social Crisis, April 2010

¹⁰ Pouliakas, Konstantinos, "Chapter 6: The skill mismatch challenge in Europe" in European Commission, Employment and Social Developments in Europe 2012, Brussels, November 2012, pp. 351-394

¹¹ cf. example of Ballymun Job Centre in Dublin Ireland, <http://www.bmunjob.ie/index.php/guidance-tools-e-learn-platform>

It is time for Europe's leaders to stop scapegoating workers and employees for the failures of governments and EU institutions to tackle unemployment. Europe will not pull itself out of crisis by pushing hard-working people towards poverty and insecurity.

To sum up, we want:

- An active zero-tolerance approach to unemployment, especially among young people. We always strive for full employment, and will continue to guard the right to chances in life through education and work
- A significant investment in skills and education - particularly through Lifelong Learning (LLL) programmes
- A fairer distribution of rights and responsibilities - between generations, genders, and public/private sector employees. People should not be played off against one another as they have been up to now
- The social partners must be actively involved in developing policy - we need tripartite negotiations if we are to achieve better apprenticeship schemes and stronger labour market arrangements
- We need to tackle the pressure on wages caused by global competition - through minimum-wage schemes, through creating and maintaining a skilled workforce, and through a shift in the tax burden away from low-income earners and towards more sustainable taxes such as an harmonised corporate tax, the Financial Transaction Tax (FTT) and taxes on carbon
- Social dumping must be prevented - we need better and tougher labour inspections, higher sanctions for abusers, and the principle of unionisation must be protected

- Participation of all sections of society - if this is to be ensured, we need, for example, to ensure that childcare facilities are provided if women are to fulfil their potential, and education will ensure that young people have chances in life

The youth guarantee is a first step toward recognising individual rights to training and to employment security. Implicit or explicit multidimensional "social pacts", pioneered with great success in the 1980s and 1990s by the Netherlands and by Denmark, would help achieve more coherence and greater acceptance by workers.

Finally, progressive labour markets need to be part of a progressive economy and a progressive society. As highlighted in a recent publication from the European Commission's DG Research, "the general strategy for extending employment opportunities cannot only be to 'make workers fit for the market' but also to 'make the market fit for workers'¹². The success of progressive labour market policies depends on a coherent approach, building on social dialogue and using the EU level to coordinate efforts and steering social progress. A social pillar of Economic and Monetary Union worthy of the name would help achieve that coherence - which is why the EMU Social Scoreboard, recently proposed by the Commission as the keystone of the social pillar, as a first step, must be made binding, just as the Macroeconomic Imbalance Procedure scoreboard is binding.

It is possible to reform the system in a way that protects the values which we, as Socialists, hold dear. The youth guarantee is the latest example of a labour market intervention which will help combat unemployment.. A true social pillar of the EMU will show that we can reach that goal. ■

¹² European Commission, New skills and jobs in Europe: Pathways towards full employment, DG Research, 2012, p.48





The European Central Bank and the Progressive Labour Market



Bernadette Ségol,
Secretary General of
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Can the European Central Bank do more to help Europe's unemployed? That is the crucial question raised in this publication.

The ECB will have no problem in replying. The standard response will be to say that not only the best but also the only contribution a central bank can make to growth and jobs is to promote price stability. The bank will also add one piece of stinging policy advice. It will suggest that, especially in a single currency area characterised by divergences and imbalances, all rigidities that hamper the functioning of labour markets need to be eliminated if the economy is to engage in a process of growth and powerful job creation.

When the central bankers of Europe talk about flexible labour markets, they mean serious business. Indeed, the ECB's view of flexibility is all-encompassing: every labour market institution or regulation that may prevent prices (wage cuts) and quantities (scrapping jobs, firing workers) from falling is being questioned, from minimum wages or sectorial collective bargaining practices to rules that offer some job protection. Moreover, as we have seen in recent years in the financially distressed economies of the Eurozone, the ECB is also prepared to use its power as 'lender of last resort' to impose, together with the IMF and DG ECOFIN, structural reforms that deregulate labour markets in individual member states, and especially wage formation processes.

Where is the evidence?

The ECB certainly has mainstream economics on its side. Indeed, since the beginning of the nineties, many papers, by both academic economists and institutions such as the OECD and IMF, have argued that unemployment can be explained by labour market interventions such as job protection, unemployment benefits and collective bargaining structures. In this view, unemployment is a structural phenomenon that can only be reduced by changing (read: deregulating) labour markets.

Here, it is useful to recall that, until a couple of years ago, this same body of mainstream economic theory was also of the opinion that financial markets were 'efficient'. Since mainstream economics considered financial markets to be very good at sorting out the right price for each investment, financial market regulation was seen as being unnecessary, even harmful. The financial crisis of 2008/2009 has totally discredited this view.

Something similar is happening to the mainstream opinion of labour market regulation. A closer look at the plentiful literature claiming that structural unemployment (in economic terms: the NAIRU or non-accelerating inflation rate of unemployment) is caused by 'rigid' labour market institutions reveals that the evidence is pretty weak, or even non-existent.

Indeed, in 2005 a group of economists undertook a critical analysis of the economic literature on flexible labour markets, examining all the major mainstream studies since the beginning of the nineties (Howell 2005).

Their conclusion was that there were many problems with the studies under review. In particular, econometric regressions were found to be 'non-robust'. This means that, using the same data, modest changes in the measurements of institutions, countries or the time period covered led to zero, statistically insignificant or even changed coefficients. In the case of one paper that was very influential in opening this discussion on structural unemployment and labour market institutions, results could not be replicated when using the same specification but with a data set that had been improved by the author himself (a bit similar to the recent Reinhard/Rogoff incident concerning their paper on the 90% of GDP public debt threshold). Another conclusion was that, whereas the link between unemployment and factors such as job protection, unemployment benefits and trade union density was highly questionable, positive or regulatory practices such as coordinated collective bargaining and active labour market policies were scoring much better in explaining different outcomes in unemployment.

Echoing the failure of mainstream economics to provide convincingly robust evidence of the benefits of labour market deregulation, the OECD, in its 2006 Employment Outlook, had to admit that it was unable to find proof that low job protection systems would result in lower unemployment. This was a rather embarrassing conclusion given the fact that the OECD, since its 1995 Jobs Study, had been systematically advocating a lowering of job protection regulation to tackle the jobs crisis.

More recently, in 2012, another team of economists (Storm, Naastepad 2012) made an update of the 2005 Baker/Howell/Schmitt analysis. They found that different studies produced such widely varying results that they were not plausible. For example, six of the nine studies found no statistically significant effect on unemployment whatsoever of increased job protection legislation. Researchers also contradict each other, with some even finding that increasing unemployment benefits leads to lower, not higher unemployment. In one paper, the level of employment protection was found to be statistically insignificant whereas an increase in the level of job protection did have an impact in lowering unemployment, a finding that again contradicts the perceived wisdom on the benefits of labour market deregulation.

To summarise, despite the consensus that rules both mainstream economics and centre stage politics, the evidence that sweeping labour market deregulation will create jobs and lower unemployment is simply not there.

Why European Central Bankers should support, not dismantle, progressive labour markets

The deeper cause of this bias in favour of flexible labour markets is that many central bankers tend to see labour market regulation as contradicting their price stability mandate. In their view, labour market institutions such as minimum wages, high collective bargaining coverage rates, or job protection legislation strengthen the bargaining power of workers, thus leading to inflationary wage hikes.

The ETUC, however, argues that the opposite is the case. In our view, a progressive labour market is based on four key principles: stability, security, fairness and progress. These are principles a central bank, from its typical standpoint of promoting price stability, should also be interested in.

Stability: Whereas central banks see stability in terms of protecting the value of financial investments, workers want stability in relation to their wages. Wages are the basis for households to secure a decent living and if employers have the power to cut wages at their own discretion, the stability of living conditions is no longer guaranteed.

The benefits of 'wage stability' extend beyond the individual worker and household. Stability of nominal wages also functions as an anchor for the entire economy. If the nominal wages building cannot come crashing down, neither can prices, and the economy cannot get caught in a spiral of falling wages and falling prices. This should be a prime concern of any central bank. Indeed, the bank's mandate of price stability works both ways: galloping inflation is to be prevented but so is the process of deflation whereby general price levels start to fall.

In fact, a central bank should be even more allergic to deflation than to galloping inflation, since the former works to disempower monetary policy. Indeed, from the moment nominal interest rates reach zero and price levels start falling, the central bank faces a situation in which real interest rates start going up in the middle of a recession. No respectable central bank would want to find itself in such a situation.

In other words, the ECB should be careful what it wishes for. Embarking on a crusade to replace the missing instrument of a currency devaluation with ultra-flexible wages and labour markets is a very bad idea.

Security: Workers also want stability in their jobs. They do not want to be in a situation where they wake up each morning wondering whether they still have a job to go to. Together with stability in nominal wages, stable employment relationships are the backbone of decent living standards.

Stable employment relationships also have advantages for the wider economy. One advantage is that they make the central bank's job in reviving the economy (and warding off the danger of deflation) much easier. Indeed, when aggregate demand starts to recover from a crisis, it is important to translate this into a self-reinforcing cycle of new jobs leading to even more demand. However, if as demand recovers, employers at the same time resort to bad labour contracts driving out good jobs and paying a lot less, there is a risk that this cycle of growth will not materialise, resulting in a weak and fragile recovery. In short, precarious jobs make for a precarious recovery and a more difficult life for the central bank that wants to revive the economy.

Fairness: A labour market cannot be progressive if it is burdened by high and rising wage and income inequalities.

Again, there are sound and purely economic reasons why a central bank should also be concerned about wage inequalities. Since high-income earners tend to save more and consume less (in relative terms), high and

The ECB should be careful what it wishes for. Embarking on a crusade to replace the missing instrument of a currency devaluation with ultra- flexible wages and labour markets is a very bad idea.

rising inequalities trigger demand to 'leak' out of the economy. To avoid depressed growth performance, policy often resorts to asset price and debt-financed bubbles so as to reboost aggregate demand and compensate for the demand leakage caused by inequalities. How better to illustrate this than by referring to the famous quote from Alan Greenspan, former chair of the US Federal Reserve, that: "If we can't increase wages, let's increase the debts of workers"?

In the aftermath of the 2009 global financial crisis, it is still shocking to read his words.

In the interest of longer term stability in the entire economic and financial system, central banks, including the ECB, would do well to counter a trend of high and rising inequalities, instead of using monetary fire power to promote deregulated labour markets. Better to increase wages and share the fruits of economic progress fairly than to continuously engage in debt-driven 'boom and bust' cycles.

Progress: Workers and trade unions do want 'change', but they want it to be positive. Professional mobility is not a dirty word for workers as long as mobility is about moving upwards and not about having to accept any kind of job, even jobs that do not provide a decent standard of living.

Here, we come back to the fact that stability in the employment relationship is good for productivity and innovation, in numerous ways. Workers with job tenure are more familiar with the production process and the business organisation. Workers on secure contracts will display more loyalty to the company than workers

with 'disposable' contracts. Workers will also be more willing to cooperate in innovation and to provide 'learning by doing' training to their colleagues when they know it will not be at the expense of their own jobs. And, employers, being aware that getting rid of workers brings a financial cost, will be motivated to offer training to their workforce so as to promote internal flexibility and react to competitive business shocks by upgrading products and production processes instead of simply shutting down product lines.

In the end, job protection, even if employers and mainstream economics have come to see it as yet another obsolete rigidity, functions as a 'beneficial constraint'. It forces business to adopt the 'high road' solutions of robust productivity and intensive innovation to competitive pressures.

Here, the benefit for the central bank is that productive and innovative progress are a much better way for economies to adjust than cutting wages. The latter risks pushing the economy into the abyss of deflation and depression, whereas the former allows the economy to grow out of its problems.

Conclusion: Not so long ago, the president of the ECB Mario Draghi claimed that 'Social Europe is gone'. This vividly testifies to the bank's bias in favour of deregulation of labour markets. Mr Draghi and his colleagues at the ECB would do well to reconsider, and rediscover the benefits a progressive labour market offers to monetary policy and price and financial stability. ■

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Reducing inequality: an essential step for development and wellbeing



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Inequality is emerging as a central issue for the post-2015 development agenda and the establishment of the sustainable development goals. Inequalities in income and wealth cause economic instability, a range of health and social problems, and create a roadblock to the adoption of pro-environment strategies and behaviour. Social and economic inequalities tear the social fabric, undermine social cohesion and prevent nations, communities and individuals from flourishing.

The Impact of Inequality

Social and economic inequality increases the power and importance of social hierarchy, status and class.¹ As a result, a long list of problems more common further down the social ladder – in poorer neighbourhoods for instance – are much more common in societies with larger income differences between rich and poor.²⁻⁴ (Figure 1) Although the impact of inequality tends to be most severe lower down the social ladder, outcomes are worse even among the better off, because inequality damages the whole social fabric of a society – increasing social divisions,

status insecurity and status competition.² Indeed, it is because a large majority of the population – not just the poor – are affected by inequality that the differences in the performance of more and less equal societies are so large. The scale of the differences varies from one health or social problem to another, but they are all between twice as common and ten times as common in more unequal societies compared to more equal ones.

Although in the rich, developed countries, income inequality is related to indicators of health and social wellbeing, levels of average income (GDP per capita) are not. Reducing inequality is the most important step these countries can take to increase population well-being. In the developing and emerging economies, both greater equality and improvements in standards of living are needed for populations to flourish.

A large and well-established body of evidence shows that very large income differences within countries are damaging. Analyses include both cross-sectional research and studies of changes in income distribution over time. There is a particularly large body of evidence linking greater inequality to worse population health; hundreds of studies show us that life expectancy is longer, and mortality lower, in more equal societies³⁻⁵⁻⁹, rates of infant mortality, mental illness and obesity are two to four times higher⁴⁻¹⁰⁻¹³ and, in both developing and developed countries, HIV infection prevalence rises with inequality¹⁴⁻¹⁵.

There is also substantial evidence linking greater equality to better social relationships within societies – levels of social cohesion, including trust and social capital, are higher in more equal countries¹⁶⁻²⁰.



Health and social problems are worse in more unequal countries

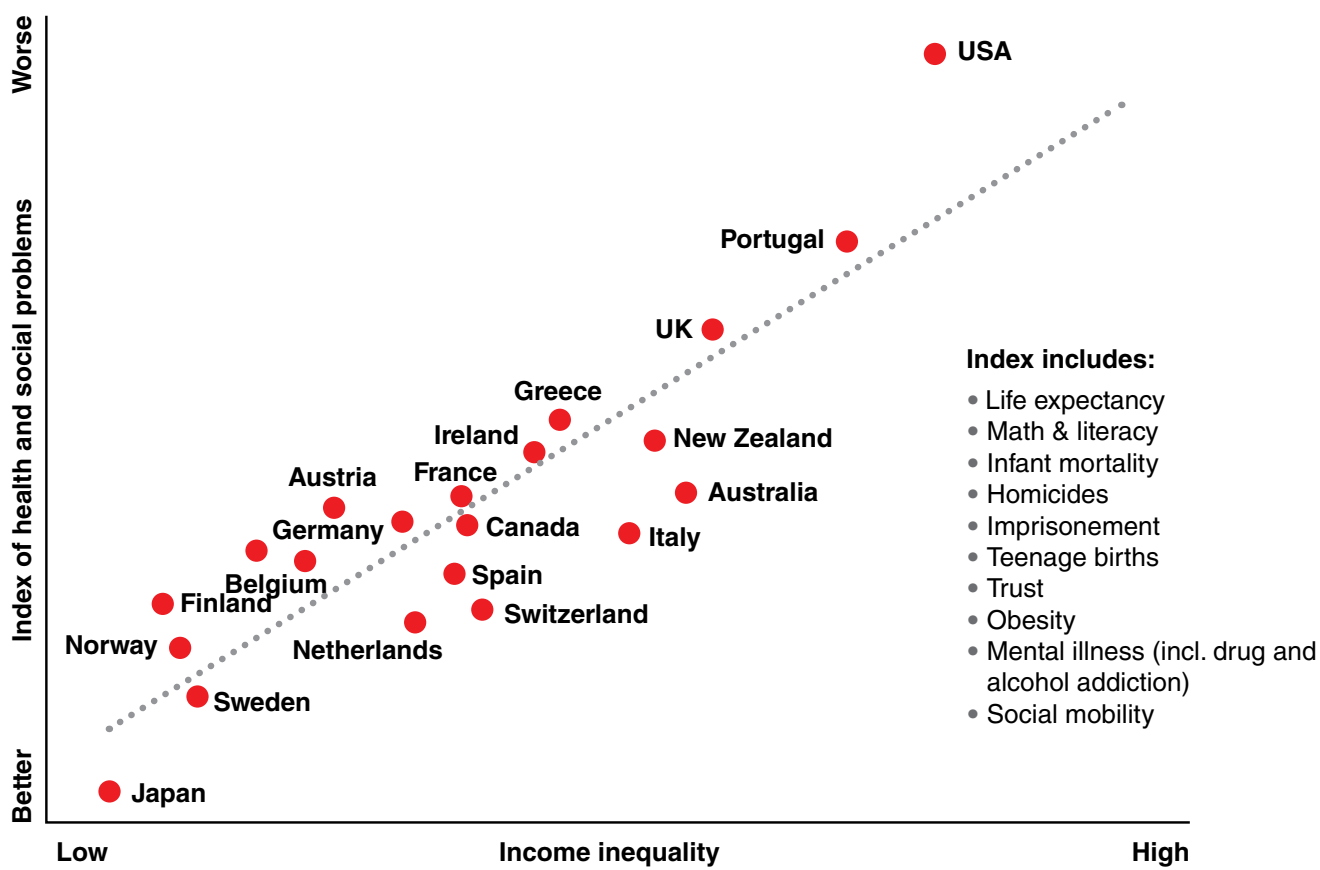


Figure 1

Given all that we now know about the effects of inequality, it seems clear that we should both monitor inequality and commit to realistic but courageous targets to reduce it.

Indicators of women's status and equality are generally better ^{1 21} and rates of both property, crime and violence, especially homicides, increase as income differences widen ^{17 22-27}.

Inequality wastes human capital and human potential. The UNICEF Index of Child Wellbeing is significantly higher in more equal societies ²⁸, educational attainment is higher, fewer young people drop out of education, employment and training, and fewer teenage girls become mothers ^{4 28 29}. Notably, social mobility is restricted in very unequal societies – equality of opportunity is shaped by equality of outcomes ^{4 30}.

In addition to its impact on health and social outcomes, greater equality is also linked to economic progress and stability. Poverty reduction, and hence development, is compromised by income inequality ^{31 32}. In rich and poor countries, inequality is strongly correlated with shorter spells of economic expansion and less growth over time ^{33 34} and with more frequent and more severe boom-and-bust cycles that make economies more volatile and vulnerable to crisis ³⁴. As an International Monetary Fund report put it – reducing inequality and bolstering longer-term economic growth may be 'two sides of the same coin' ³³.

Greater equality has an important role to play in the necessary worldwide transition to sustainable economies. Inequality drives status competition, which drives personal debt and consumerism ^{1 35-38} and, of course, consumerism is a major threat to sustainability. Stronger community life in more equal societies also means that people are more willing to act for the common good – they recycle more, spend more on foreign

aid, score higher on the Global Peace Index ¹, and business leaders in more equal countries rate international environmental agreements more highly ³⁹.

Reducing Inequality

Income differences can be reduced via redistribution through taxes and benefits, or by reducing differences in pre-tax incomes. The international evidence suggests that greater equality confers the same benefits on a society whether it is achieved through one of these approaches or the other ¹.

In general, top tax rates, which in many countries – including the USA – were over 80% in the 1970s, have been reduced dramatically and there is room for more progressive tax to be restored. Dealing with tax havens and other methods used by rich individuals and large companies to avoid tax is crucial; the amount of money lost by developing countries to tax havens exceeds all international development aid ^{40 41}. This not only increases global inequality but also means that a higher proportion of public expenditure has to be funded by tax payers in lower income groups. In many countries taxation has ceased to be significantly redistributive.

Forms of economic democracy, such as employee ownership, employee representation on boards, employee share ownership, mutuals and cooperatives tend to reduce the scale of income inequality and help equality to become more embedded in a society – these are more long-lasting cultural changes than can be achieved through tweaks to the tax code. These forms of business institutions also provide a more stable basis for community life and perform well in ethical terms.



Marking Progress

Given all that we now know about the effects of inequality, it seems clear that we should both monitor inequality and commit to realistic but courageous targets to reduce it. A core objective of the post-2015 development framework and the sustainable development goals should be to reduce inequality within countries⁴². The frameworks should include a top-level goal to reduce inequalities, including income inequalities in particular. This should be in addition to disaggregated indicators and targets in every other goal to ensure equitable progress across different social groups towards agreed development objectives.

An inequality target could be based on Palma's ratio of the income share of the top 10% of a population to the bottom 40%. In more equal societies this ratio will be one or below, meaning that the top 10% does not receive a larger share of national income than the bottom 40%. In very unequal societies, the ratio may be as high as seven⁴³. A potential target could be to halve national Palma ratios by 2030, compared to 2010, and dramatically reduce the global Palma ratio, which is currently³².

Prioritising the need to tackle inequality in this way will ensure that economic and development strategies are truly inclusive and can drive human progress towards sustainability and wellbeing. ■

Sources for Further Information
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The Equality Trust www.equalitytrust.org.uk

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European Social Union: a political necessity and an urgent research programme



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Progressive economic analysis should contribute to a coherent conception of the reasons behind, the agenda for, and the governance of a European Social Union. I use the words 'European Social Union' deliberately, for the following reasons. First, it would be wrong to assert that the EU has no social dimension today.

The coordination of social security rights for mobile workers, standards for health and safety in the workplace, some directives on workers' rights... constitute a non-trivial *acquis* of fifty years of piecemeal progress. The EU also developed a solid legal foundation for enforcing non-discrimination among EU citizens. The notion of a 'European Social Union' is not premised on a denial of that positive *acquis*: that would be intellectually incorrect and politically counterproductive. However, although the next steps we have to take can build on that *acquis*, their nature and rationale respond to a new challenge. A Social Union would support national welfare states on a systemic level in some of their key functions (such as macroeconomic stabilisation) and guide the substantive development of national welfare states – via general social standards and objectives, leaving ways and means of social policy to Member States – on the basis of an operational definition of 'the European social model'.

In other words, European countries would cooperate in a union with an explicit social purpose – hence, the expression 'European Social Union' (ESU). My argument is that ESU, so conceived, is not only desirable but necessary (Vandenbroucke, 2013). To make that analysis is not to say that an operational concept of ESU is already on the table. On the contrary, important issues have to be clarified, intellectually and politically. Specifying what ESU would mean in practice is a key research question for progressive economists, sociologists and political scientists.

1. Excessive social imbalances in the Eurozone

Next to the problem it creates for the political legitimacy of the European project, the disparity and divergence in child poverty (to focus on that case) can be seen as signaling objective economic problems that affect the sustainability of the Eurozone. A comparatively high level of child poverty is synonymous with an investment deficit that may be cause and effect in a vicious circle of underperforming labour markets and education systems. Today, we witness huge imbalances across the Eurozone with regard to labour market outcomes, formal educational achievements and educational outcomes. If some members of the Eurozone get trapped into a vicious circle of underperforming labour markets and education systems, such a 'bad equilibrium' creates an objective problem with regard to the economic symmetry that is required among the members of a monetary union.



A 'European Social Union' is not only desirable but necessary. In order for such a consensus to engender broad political support, it must adhere to the objectives that the European welfare states have in common. It cannot contradict the normative foundations of European welfare states. Making that idea – the notion of a genuine ESU – operational constitutes both a political necessity and an urgent research programme.

The latter argument fits in into a broader debate on the consequences of monetary unification. The members of a currency area are confronted with a trade-off between symmetry and flexibility. Flexibility is explained in terms of wage flexibility, labour mobility and migration, which determine a country's 'internal' adjustment capacity in case of an asymmetric shock. Less symmetry necessitates more flexibility, according to the theory of 'optimal currency areas'. But there is a second trade-off: if the possibility exists of absorbing asymmetric shocks through budgetary transfers between member states, then the need for flexibility is reduced.

In economic textbooks explaining this trade-off, symmetry is defined in purely economic terms, but sustaining symmetry in the long run may imply a degree of social convergence. Neither flexibility nor symmetry, nor indeed budgetary transfers, are socially neutral choices. The long-term trade-offs¹⁴ implied by monetary unification force upon the participating countries a consensus on the social order the monetary union has to serve. This analysis does not lead to unequivocal normative conclusions about the kind of social model the EU ought to develop. It does, however, show the inevitability of a basic consensus among the Eurozone members, encompassing cognitive as well as normative elements:

- Cognitive: to what degree does economic symmetry also imply social convergence? Which degrees of freedom exist with regard to pension systems and retirement age, educational achievements, child poverty...?

- Normative: if we agree that economic symmetry presupposes social convergence in some domains, then common benchmarks need to be set as targets for organising such convergence.
- Cognitive and normative: what is our view on the role of flexibility and pan-European transfers?

The last question – on pan-European transfers – refers to macro-economic stabilisation in the EMU. Can a European stabilisation mechanism contribute to restoring the systemic stabilisation capacity of national welfare states that is now constrained by monetary unification? Many agree that EMU necessitates a stabilisation mechanism. The elaboration of that idea entails complex questions: some researchers emphasise asymmetric shocks and propose 'interstate insurance', triggered by economic indicators (Enderlein e.a., 2013; Drèze and Durré, 2013). Other researchers argue in favour of a European Unemployment Insurance, which would answer both to asymmetric and symmetric business cycle shocks (Dullien, 2013). That important debate is far from settled.

I do not purport that the monetary union will only survive if it meets the requirements of social justice as I would define it. My claim is more limited: the sustainability of that union requires a consensus on the social dimension. However, in order for such a consensus to be broad-based, it must tie in with the goals that the European welfare states have in common. In the past, it has often been stressed that the European welfare

¹⁴In addition to the described trade-offs, there are other conditions for the sustainability of a monetary union. One is particularly topical at the present moment: a banking union.

states are so diverse that it is impossible to accurately define the European social model. Nonetheless, however diverse the reality of European welfare states, at this time a minimal consensus is needed on common, normatively charged objectives of social policy.

2. National cohesion and pan-European cohesion: two perspectives on solidarity

Excessive social imbalances and the functional consequences of monetary integration are not the only problems which should inspire a conception of ESU. Discussions about social Europe often refer to the prevention of social dumping and the preservation of national sovereignty in the domain of social policy on the other hand. In this short essay, I cannot do justice to the debate that these issues warrant. Although my view on this matter is nuanced, I believe there can be a critical interaction between the absence of pan-European social standards and reduced legal sovereignty of the Member States. An example concerns minimum wages and posted workers. With regard to labour market regulation, two problems have to be tackled at the EU level: all Member States should have a universal system of minimum wages, which are decent with regard to their (national) average level of wages; and posting of workers must not undermine national systems of collective bargaining, for instance with regard to minimum wages.

The arguments sketched so far, on excessive social imbalances and the consequences of monetary unification, on specific issues of social dumping and national social sovereignty, point in different directions, but – if coherently applied – they are not mutually exclusive. The arguments related to EMU are premised on the idea that the tuning of economic strategies requires a minimal tuning of social policy. Hence, the search for a strong consensus on the content of the European social model is no longer a superfluous luxury, but a necessity. However, the tuning of social strategies in Europe must not lead to the application of an undifferentiated social policy. Nor is it incompatible with the notion that Member States should retain sovereignty in specific areas (e.g. legislating or bargaining on minimum wages, the organisation of health care): the Member States must be able to effectively assume the responsibilities they bear. The latter idea is, in turn, not incompatible with the notion the EU should set certain minimum standards, for instance with regard to the universal applicability of decent minimum wages within every Member State. How the stabilisation function of welfare states can be restored, how social imbalances across Europe can be reduced, how far policy tuning should go, how to organise it democratically, how stringent minimum standards might be, and the extent to which a distinction should be made between countries within and countries outside the Eurozone... are by no means simple matters. But the necessity of a European Social Union, encompassing these different elements, must be high on our agenda.



The foregoing discussion shows that a European Social Union implies two perspectives on the meaning of 'solidarity in Europe': the arguments with regard to the EMU imply a pan-European notion of solidarity; other arguments are first of all motivated by the value of national cohesion and national, domestic solidarity. Historically speaking, the European Community has always pursued the goals of enhancing national and pan-European cohesion concurrently.

3. Social investment on the agenda

How can we create a virtuous cycle whereby both pan-European cohesion and national cohesion are enhanced? If there is an area today where the European Union needs a 'pact' for setting long-term goals in a spirit of reciprocity, then it is social investment (Vandenbroucke, Hemerijck, and Palier, 2011). Social investment focuses on policies that 'prepare' individuals, families and societies to adapt to various transformations, such as changing career patterns and working conditions, the emergence of new social risks and population ageing, rather than on simply 'repairing' damage caused by market failure, social misfortune, or poor health. The social investment concept is not new, but the fundamental societal trends that necessitated this approach are as relevant and important today as they were ten years ago, perhaps even more so because of adverse demography. The agenda involves high-quality childcare; investment in training

and schooling, at all levels of education; support for the combination of paid work and family life; later and flexible retirement, in accordance with life expectancy; seizing the opportunities presented by migration, through among other things proper integration into education and the labour market; and minimum income protection and, in general terms, capacitating service provision. Adding 'minimum income protection' is not superfluous: we need to develop social investment and social protection as complementary pillars: one cannot replace the other and a one-sided view should be resisted. That is the lesson Bea Cantillon and I draw from past experience, in a new volume on poverty and work in the EU (Cantillon and Vandenbroucke, 2014).

The European Commission recently adopted a Social Investment Package (European Commission, 2013), which marks an important turn in the current thinking in at least part of the European Commission. Obviously, social investment is a long-term agenda. It would be naïve to think that it can resolve the short-term issues presented by the ongoing economic and financial crisis. In policy terms, the challenge is to make long-term social investments and medium-term fiscal consolidation mutually supportive and sustainable, under improved financial and economic governance. This requires a more balanced approach to macro-economic coordination itself, and a close link between economic and social governance. For instance, the schedule of fiscal consolidation could be revised in countries confronted with zero-growth prospects and effectively seeking a higher

quality of spending and administration (Tillhaye, 2013).

The drive for reform in the Member States should be based on genuine reciprocity. Obviously, the performance of welfare states is first of all a responsibility of the Member States themselves. On a pan-European level, however, there is a common interest in having well-performing welfare states. As a matter of fact, explaining why countries perform so differently with regard to child poverty is not straightforward: there is a lot of evidence, but no hard science that can trump political deliberation (Vandenbroucke et al., 2013). This implies that a contractual (reciprocity-based) approach should be far removed from a top-down, 'one size fits all' approach to social policy-making in the Member States. What is needed is a combination of (i) greater room for manoeuvre and support for Member States which opt for a social investment strategy and (ii) policy guidance based on clear and sufficiently stringent and constraining objectives with regard to well-defined social outcomes on the one hand, and genuine scope for exploration and mutual learning on the ways and means to achieve those outcomes on the other hand.

4. Conclusion: developing an idea that is no longer a luxury, but a necessity

ESU means that the EU would support the systemic stabilisation functions of national welfare states and guide their substantive development, via general social standards and objectives, leaving ways and

means of social policy to Member States. That presupposes a sufficient degree of consensus on the goals of social policy. Such a basic consensus may assume a variety of shapes, depending on the underlying conception of social justice and the significance attached to it. However, in order for such a consensus to engender broad political support, it must adhere to the objectives that the European welfare states have in common. It cannot contradict the normative foundations of European welfare states. Making that idea – the notion of a genuine ESU – operational constitutes both a political necessity and an urgent research programme. ■

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IAGS-2014

Choosing policy coordination or structural divergence?



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The latest economic developments have raised new hopes that the Eurozone can finally escape from yet another year of recession. However, a positive GDP growth rate does not make a recovery. The financial, economic and social crises have left their prints. Avoiding a separation of the Eurozone does not mean escaping its fragmentation. Though some macroeconomic imbalances have certainly been reduced, new social-related ones have been building up.



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The aim of the iAGS-2014 report is to shed light on the roots of the upswing in the economic outlook, as well as on the new difficulties which arise. The return of growth is necessary but remains insufficient to solve all the major challenges facing the Eurozone. A proactive policy should be supplemented. It should rest on enhanced cooperation between countries. It should promote higher growth in the short term and improve future prospects for potential growth.

The GDP growth figures of the second quarter of 2013 have been a pleasant surprise. They match the recent improved economic outlook. Confidence in the

industry sector and households' confidence have gained momentum. Sovereign spreads have decreased in Italy and Spain; and fears of a Eurozone break-up have slowly vanished. Monetary policy is still expansionary. Even if the ECB could have done more, it has avoided a large liquidity squeeze, which could have led to a collapse of major European banks. Furthermore, the European Commission has proposed new deadlines for correcting the excessive deficits. Even if it has not yet recognised officially that austerity has failed, the new targets will lessen the fiscal consolidation efforts to be endeavoured in 2014.

The recession in the Eurozone has numerically ended in the second quarter of 2013. GDP has grown by a positive 0.3% after six consecutive quarters of contraction. This performance is largely due to Germany and France. Nevertheless, annual growth in the Eurozone will remain negative in 2013 and is expected to turn positive only in 2014. Growth is not strong enough to be considered as a recovery. In countries facing high unemployment, growth will be weaker than in the rest of the Eurozone: this will not provide sufficient momentum to significantly decrease unemployment. One reason is that southern countries, namely Spain, Greece and Portugal, are still engaged in austerity plans. Even if it were lower, following the Commission's understanding, austerity will have the biggest impact on household income because the pressure has eased on many businesses in order to foster competitiveness. Internal demand, in those countries, will be cut and deflationary processes will go on, due to high



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unemployment and to “structural” reforms liberalising labour markets. External demand is preferred to internal demand as the way out of the crisis.

Urged to undertake structural reforms to enhance long term growth and to improve competitiveness, the Eurozone is on course to develop a new disease. Competitiveness has been improved, but private demand remains low. Consequently, growth rests only on the positive contribution of the external sector, and investment by firms will restart progressively. But since all Eurozone countries are seeking growth using the same tools, the expected gains would be at best small when all the efforts to foster competitiveness will be netted. No authority, no coordinating body is able to implement a consistent policy. Each country expects that the others will buy its exports. This will lead the Eurozone to a bad equilibrium where the internal is sacrificed with no gain in terms of external demand. The external demand for Eurozone exports will never be sufficient to reverse the situation and to correct the damage done to internal demand. The euro area is too large and too closed for that to happen. High unemployment and the blind race for competitiveness will fuel deflation and fragmentation. New imbalances will replace the previous one: poverty risk and inequalities are going to rise, feeding social instability. Private debt, under nominal devaluation of incomes, will get heavier calling for further socialisation of bank losses. Public revenue will melt with lower incomes, requiring more austerity and improved competitiveness. This process of fiscal competition and internal devaluation is rooted in the design of the Eurozone. The

present crisis will unleash to a point never before seen.

Consequently, divergence between EMU countries will widen. The paradox being that the attempt to solve macroeconomic imbalances will create larger and more general imbalances. Despite positive growth, the catch-up process will be reversed for countries in Southern Europe. Wage deflation in the south will bring the periphery back to where it was, in relative terms, a few decades ago. GDP growth will be higher in Germany than in the rest of the Eurozone. Internal and external demand will sustain economic activity in Germany where the federal government and firms have managed to preserve competitiveness and where the low level of unemployment has left leeway for wage increases. Conversely to most Eurozone countries, the growth rate there could be close to its potential, whereas it could be below for most other countries, including France.

France is, in fact, at the frontier between deflationary countries and structurally competitive countries, but will probably fail to be either. Consequently it will lose its political persuasion for an alternative path for Europe. Nothing will prevent the economic, social and political fragmentation of Europe. These imbalances feed diverging interests and social challenges, which put the European project at risk of dissolving.

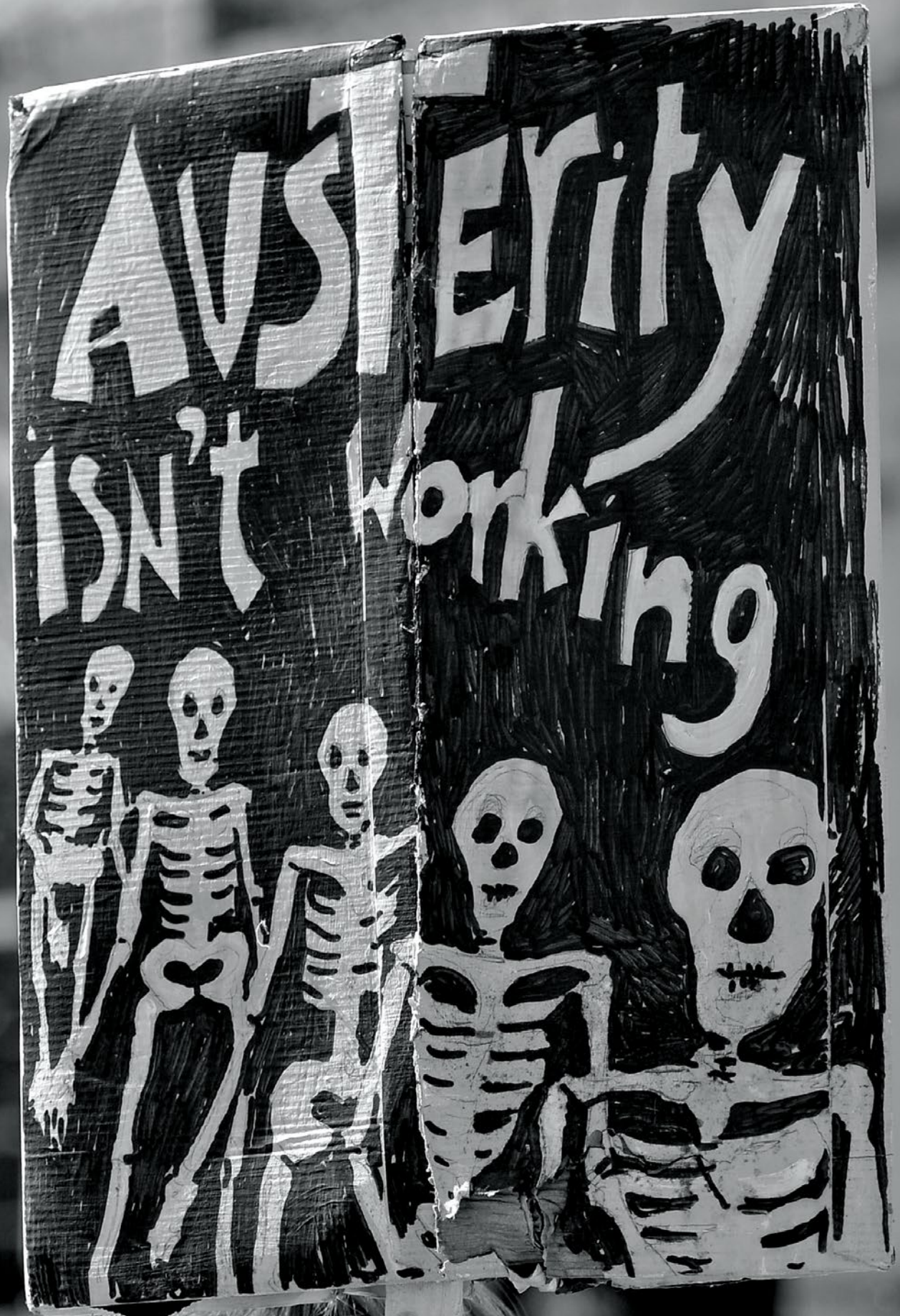
This is an emergency: Eurozone countries need to cope with both increased geographical and income inequalities. So far, the current governance of the Eurozone has not been helpful in tackling this issue. Fiscal rules have largely been used to downsize fiscal deficits: the ensuing failure was largely

The Eurozone should not be afraid to invest more and to develop public and coordinated investments.

emphasised in the iAGS-2013 report. Up until now, the new macroeconomic imbalances procedure (MIP, included in the scoreboard) has mainly been invoked to urge countries to improve their competitiveness, contributing to deflationary pressures in Southern Europe. Another strategy needs to be considered. It should be based on closer coordination between EMU countries. Minimum wage policy could be a tool for stopping deflation, reducing inequalities, limiting nominal competitiveness and current account imbalances. Each country would have a specific process for controlling minimum wages, allowing for decentralised as well as centralised negotiation. The level of the norm could be different for each country, reflecting different levels of productivity or different structure of the productive sector. However all countries will define a dynamic target that is useful for minimum wage to median wage ratio, aiming at fair inequalities and decent pay. Moreover, countries with current account surpluses would have to increase minimum wage norms more than deficit countries each year, in an attempt to reduce macroeconomic imbalances. The MIP may be used to this end as it provides a battery of indicators intended to gauge imbalances. However, two improvements are required: first, the MIP should be used symmetrically

and, second, it should give more weight to social variables, especially the unemployment rate. Beyond the analysis of the current weaknesses of the Eurozone's mild recovery, the iAGS-2014 report will give a clear picture of the existing minimum wage policies in the EU, and it will establish a minimum wage norm for all EMU countries.

Another challenge for Europe is to enhance investment through a coordinated plan. There is a need to promote an ambitious initiative in order to sustain growth in the short term and to enhance potential in the medium term. The main objectives have been already defined in the Europe 2020 Strategy and in the Compact for Growth and Jobs agreed upon in June 2012. Notably, it entails investing in renewable energy, energy renovation and in transport. From 2013 to 2020, it could amount to an overall investment of roughly €200 billion per year. Such an initiative implies not only political will but also the release of European funds. The project bonds already provides a mechanism for sustaining investments but the Eurozone should not be afraid to invest more and to develop public and coordinated investments. The iAGS-2014 report will enlighten the possible costs and expected benefits of such an initiative. ■



Can the ECB do more for Europe's unemployed?

With Basket-Eurobonds the ECB could act like the FED



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I. The Euro area is suffering from insufficient macroeconomic stabilization

At the end of 2009 the unemployment rates of the Euro area and the United States had reached a level of 10%. Since then, unemployment in the US has fallen to 7.3% while in the Euro area it has climbed to 12.0%. This is not surprising as the real GDP in the United States is now 9.0% above the level of 2009, but in the Euro area it has increased by only 2.4%.

These outcomes are very closely related to very different macroeconomic approaches. The US's fiscal policy tried to stimulate the economy with very high deficits. On average in the years 2010 to 2013, the annual US fiscal deficit was 8.7% of GDP. This is more than twice the Euro area's deficit, which was only 4.3% of GDP. Thus, unlike the United States which made ample use of their fiscal capacity, the Euro area - especially the member countries which were most affected by the economic downturn - was forced to pursue a restrictive policy which aggravated the recession.

Different approaches can also be identified in the field of **monetary policy**. Almost immediately after the Lehman collapse, the FED reduced interest rates to the zero lower bound. The ECB followed a much more cautious approach. After Lehman, the ECB did not go below 1% with its own interest rate - instead it raised it again in two steps to 1.50% in July 2011. It took almost two more years before the Eurozone rate was reduced to 0.50%. The more active approach of the FED is also

reflected in its quantitative easing policy. Since Draghi's strong statement on 26 July 2012, the ECB's bond holdings have declined from 602 billion Euros to 600 billion Euros. At the same time the FED has increased its bond portfolio from 2,472 billion Dollars to 2,844 billion Dollars.

With this in mind, the weakness of the Euro area economy cannot only be explained through structural problems. Rather, it has more to do with an insufficient macroeconomic response to a severe macroeconomic crisis. This is also reflected by a comparison with the United Kingdom which according to all indicators is the EU country with the most flexible goods, service and labour markets. Nevertheless, in order to stabilise the UK economy in the years 2010 to 2013, an average fiscal deficit of 8.0% was needed and the bond purchases of the Bank of England were even more aggressive than the quantitative easing of the FED.

Of course, the rather weak macroeconomic stabilisation in the Eurozone to a large extent reflects the specific political and institutional framework of this currency area. In contrast to the United States and the United Kingdom, the member states of the Eurozone are indebted in a currency which they cannot print under their national autonomy. This exposes them to an insolvency risk which is not the case for other developed countries. As a consequence the weaker Eurozone members were confronted with "bond-runs" of global investors in the years 2010 to 2012, which in the case of Greece, Ireland and Portugal could only be stopped by a rescue programme which required very restrictive stabilisation under the aegis of the Troika.



Structural reforms can be helpful to improve the competitiveness of the Euro area. But without a dynamic macroeconomic environment, improvements at the microeconomic level will not materialise.

As far as the ECB is concerned, its ability to engage in a comprehensive quantitative easing programme in the style of the FED or the Bank of England is limited by the fact that there is no integrated market for Eurobonds. Especially in Germany, ECB purchases of bonds from individual countries are criticised as a hidden form of government financing which is prohibited by European Treaties.

II. Basket-Eurobonds: A way to overcome the German resistance to Eurobonds

Fundamental changes to the institutional framework of the Eurozone cannot be expected for the time being. Therefore, one has to ask how better macroeconomic management could be achieved within the present legal constraints.

In the last few years, several proposals for Eurobonds or quasi-Eurobonds, such as the debt redemption pact of the German Council of Economic Experts, have been developed. But so far it has not been possible to convince German politicians and the German public that joint and several liability for Eurozone debt is required to guarantee the survival of the Euro and that the risks of such a step can be controlled. In addition, any form of joint and several liability poses serious legal challenges.

A possible way out could be a synthetic Eurobond which is designed as a **basket of national bonds** where each country guarantees only for its share in the basket. While such a basket-Eurobond would be issued and traded as a single debt instrument, each participant would be liable

only for the interest payments and principal redemption corresponding to its share of the bond, and not for the debt of the other issuers (Favero and Missale 2010, p. 99). Proposals for such an instrument were made already by the Giovannini Group (2000), the European Primary Dealers Association, in 2008.

A decisive feature of such a basket-Eurobond (BEB) is the share of the individual members.

It could be either determined by the **GDP weights** of the member countries or by the share of their outstanding national government debt in total government debt of the Euro area. A basket according to **debt weights** would give Italy a share that is higher than its GDP share. A basket based on GDP shares would give Germany the strongest weight, while Italy's share would be smaller than its debt share (Table 1). For the credibility of the basket-Eurobond a large German share would be more beneficial for the Eurozone. In addition, for the ECB only a Eurobond with GDP shares would avoid the criticism of implicit government financing.

Basket-Eurobonds could be issued together with a sizable issue of national bonds. Alternatively one could envisage a solution where almost all new bonds of the member states are issued as basket bonds. A **large issue of basket bonds** would have the advantage of a fluid market with correspondingly low interest rates. A fully developed BEB market would be much more fluid than each of the existing national markets. In addition, it would limit investor shifts from one national bond market to another, which has been a major source of instability in the last few years.

Country	Debt share	GDP share
BE	4.4	4.0
DE	24.2	28.1
EE	0.0	0.2
IE	2.3	1.7
GR	3.5	2.0
ES	10.1	10.8
FR	20.9	21.4
IT	22.8	16.5
CY	0.2	0.2
LU	0.1	0.5
MT	0.1	0.1
NL	4.8	6.3
AT	2.5	3.2
PT	2.3	1.7
SI	0.2	0.4
SK	0.4	0.8
FI	1.2	2.0

Table 1

A strong expansion of the BEB market could be achieved if all new German bonds were issued as basket bonds. With a basket according to GDP shares, this would imply that countries with a debt share exceeding their GDP share (Italy, Ireland, Portugal and Greece) are forced in addition to issue a relatively small number of bonds as stand-alone national bonds. But as these countries are able to raise a very high share of the new issuance under the umbrella of the basket bond, the risk for the remaining bonds would be rather limited. In addition, some market discipline could be maintained.

For countries with a debt-to-GDP ratio below the German ratio a GDP weighted basket implies that they would raise more funds from the capital market than their funding requirement. The difference could be invested by the issuing institution (Euro Debt Agency) in assets with the same rating as the corresponding countries.

From a German perspective the main problem of a basket bond could be higher **financing costs**.

The interest rate for the basket bond would be higher than the interest rate for a traditional German bond. This problem could be solved by differentiating the interest payments for the participants according to their individual debt levels. For instance, for each percentage point of the national debt-to-GDP ratio below the Eurozone average, a certain discount on the interest rate of the basket bond could be made. For countries with above-average debt levels

a corresponding surcharge would be applied. This mechanism would provide better incentives and disincentives than the bond markets which for many years did not react to the differences in debt levels and then overreacted after the crisis had started in 2010.

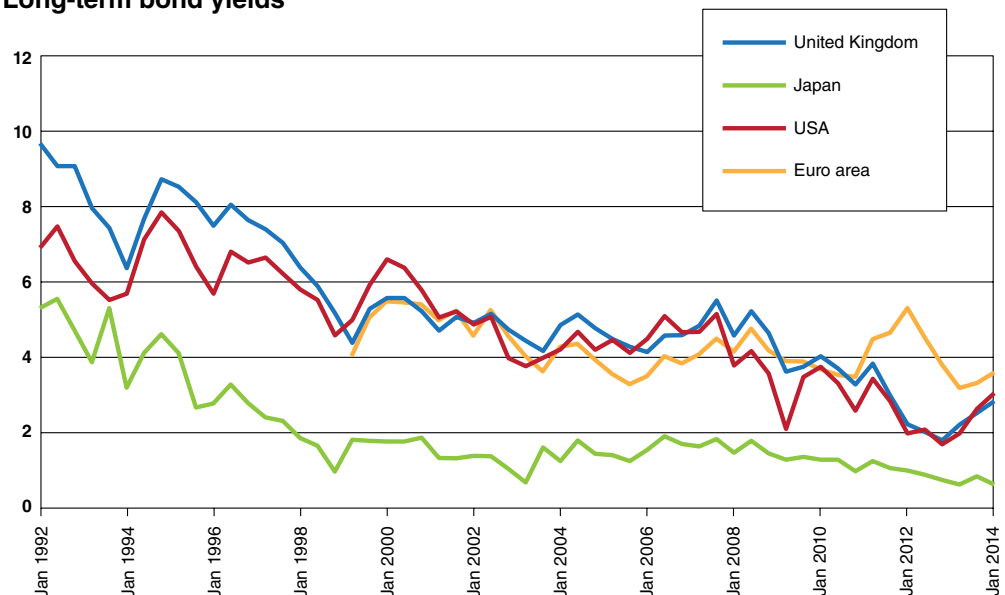


III. The ECB's potential for quantitative easing

A well-developed market for Euro-basket bonds would facilitate the ECB to engage in a policy of **quantitative easing** in the same way as central banks of other major currency areas. With an explicit commitment by the ECB to purchase a certain number of basket bonds for an extended period of time, the average long-term interest rate of the Eurozone could be reduced.

Since the outbreak of the financial crisis, this rate has been considerably higher than long-term bond yields of other major currency areas (see chart). Fundamentally this spread is not warranted as the average deficit of the Eurozone has been lower than the deficit of other major currency areas. At the same time, the Eurozone debt level has been more or less identical to the US and the UK level, but much lower than the Japanese level.

Long-term bond yields



Although the IMF expects a return to growth in the Eurozone in 2014 and growth rates of about 1.5% in the following years, the Euro unemployment rate will increase to 12% in 2014 and will remain above 11% until 2017.

Of course, since July 2012 the ECB's **Outright Monetary Transaction (OMT) announcement** has already helped to reduce the average interest rate considerably. But there is a risk that this commitment could be tested and that the ECB's purchases of national bonds could be limited by legal concerns. With purchases of BEBs the ECB could always argue this is a purely monetary operation as it does not favour individual countries.

At the moment the ECB's bond holdings amount to 6.3% of the Eurozone's GDP, the FED's bond holding total 17.5% of GDP. The monthly gross issuance of government bonds of Eurozone member countries is about 200 billion Euros. Thus, after the establishment of BEBs the ECB could announce monthly purchases of 50 billion Euros for a 12 month period.

The total amount of 600 billion Euros would be equivalent to about 6% of the Eurozone's GDP. It would double the ECB's bonds holdings and help reduce the average Eurozone bond rate, as it will take the same time until a major number of BEBs become available. The ECB could start its OMT programme by purchasing national bonds according to the GDP weights of the member states.

Of course, the implementation of a BEB would raise a host of **technical questions**, above all concerning the legal status of the Euro Debt Agency, the timing of issues and the maturity of the BEBs. Nevertheless, BEBs are the only form of Eurobond which do not require joint and several liability and they are therefore the only instrument that can be implemented within the current institutional framework.

IV. Hope for the unemployed

In spite of some positive signals the overall economic situation of the Eurozone is still rather bleak. The HICP inflation rate is now only 1.1% which is almost in a deflationary terrain as it is below the ECB's target of close to 2%. Although the IMF expects a return to growth in the Eurozone in 2014 and growth rates of about 1.5% in the following years, the Euro unemployment rate will increase to 12% in 2014 and will remain above 11% until 2017.

Of course, structural reforms can be helpful to improve the competitiveness of the Euro area. But without a dynamic macroeconomic environment, improvements at the microeconomic level will not materialise. Under the current legal framework, the fiscal space of the Eurozone member states will remain very limited. Therefore, the ECB will remain the only powerful actor at macro level. Its commitment to OMT has already shown a remarkable impact on financial markets. With the issuance of basket Eurobonds the ECB's ability to engage in a policy of quantitative easing could be significantly improved. In addition purchases of such bonds could no longer be criticised as a form of implicit government financing ■

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The Case for a Dual Mandate for the European Central Bank?



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The nomination of Janet Yellen as the next Chairman of the Federal Reserve System, announced recently by President Obama, sparked an interesting discussion on the Fed's intentions over the next months and years. In particular, commentators speculate on how Yellen will manage the transition from the current exceptional circumstances to a more normal state of affairs, and how she will deal with tapering, the reversal of the bond buying program known as "Quantitative Easing".

Yellen is known to be sensitive to unemployment and growth, so her nomination will most probably mean a slower tightening of monetary policy. Evidently this discussion is relevant for the prospects of the world economy but it also has interesting insights for the discussion on ECB action and on monetary policy in the Eurozone. In fact, the confrontation between "doves" and "hawks", which animates the Federal Reserve Open Market Committee meetings would hardly be seen within the ECB Council, where diversity of views, assuming it existed, would in general not lead to changes in policy choices. The reason for this difference can possibly be

found in the debate on macroeconomic policy, but more probably in institutional differences across the ocean.

1. The Theoretical Foundations of Inflation Targeting

It is well known that the Maastricht Treaty assigns to the ECB a strict inflation mandate, and that only "Without prejudice to the objective of price stability, it shall support the general economic policies in the Community" (art. 2). In the United States, instead, the Full Employment and Balanced Act of 1978 (the Humphrey-Hawkins Act) amended the Federal Reserve Act in establishing a dual objective of price stability and full employment for monetary policy. These different institutional setups are no accident, but reflect the intellectual environment in which they came to light. The Humphrey Hawkins Act dates from a period in which Keynesian dominance in academic and policy circles posited a role for macroeconomic policy. As a consequence, monetary policy could, and should, have full employment among its objectives.

The Maastricht Treaty, on the other hand, centred European economic governance on the rejection of active macroeconomic policies: the ECB only has a mandate for price stability, and has considerable autonomy in pursuing it. Furthermore, the "Stability and Growth Pact" of 1997 and the newly implemented "Fiscal Compact" force countries (which, even within the EMU, remain in charge of fiscal policy) to rely solely on automatic stabilisers to cushion economic fluctuations.



Rethinking the ECB's mandate could be an important step towards a federal state that today seems the only durable solution to European woes.

This “Berlin-Washington Consensus” (Fitoussi and Saraceno 2013) has its theoretical foundations in the neoclassical Walrasian theory. In a nutshell, the theory postulates the centrality of markets populated by rational agents who, if left free to operate without distortions, tend to favour “optimal” equilibria, characterised by full employment of resources and the maximisation of a representative agent's welfare (Pareto efficiency). Price and wage flexibility, then, ensure that demand adapts to full-employment supply. The emphasis of the theory is then on supply-side measures capable of increasing the capacity of the economy to produce. Barring exceptional circumstances, this view considers aggregate demand management useless, if not harmful. And if supply side policies, reducing wages and social protection, were to have a negative impact on private demand, this would be more than compensated for by the export-led growth induced by gains in competitiveness.

Within the Walrasian framework, equilibria can be ranked, with one superior equilibrium to which the market economy spontaneously tends once the appropriate conditions are met. This has a very strong policy implication: the only role for economic policy is to make sure that barriers to free competition (monopolies, asymmetric information, rigidities) are removed through “structural reforms”, so that markets are able to converge to the optimal equilibrium path. Policy is not supposed to make choices, but only to clear the ground of obstacles to the free unfolding of market forces, leading to a state that, by definition, represents the

best of all possible worlds. Technocrats are actually preferable to politicians, not only because they are supposedly more competent, but also and especially because they are free from the vested interests and political bias that could lead to market incentives' distortions. In addition, they are less constrained than politicians by the “fetters and constraints” of democracy.

A crucial corollary of the Walrasian framework is that money, whose intrinsic utility is zero, is only demanded for transaction motives. It stems from this that, at least in the long run, money is neutral, i.e. that it has no impact on the real sector, and only affects prices and inflation. In the short run the existence of rigidities may imply that monetary policy has real effects, as is for example the case for New-Keynesian models (see e.g. Woodford 2003). However, long run neutrality dictates that even in these cases the best central banks can do is to keep strict inflation targets, thus anchoring private sector expectations and minimising deviations from the optimal path of the economy. Rules (be they fiscal or monetary) are justified by the same token: they avoid policy-induced uncertainty, minimise the risk of biases in government action, and provide a stable environment for investment and growth.

It is much harder to accept government by technocrats or by rules, however, if one believes with the Keynesian tradition that economic processes are inevitably characterised by failures and imperfections, be they of markets or of policy makers. If we abandon the platonic idea of a superior Walrasian equilibrium, we are forced to accept the existence of a

plurality of possible trajectories for the economy, resulting from the interaction of markets, institutions and public policies. This multiplicity of equilibrium paths, not necessarily ranked in terms of welfare, forces policy makers to choose a particular trajectory and therefore, among other things, one of the many possible distributions of resources between the different actors involved in the economic process.

The importance of endowing monetary policy makers with the capacity to make (sometimes hard) choices has become all the more evident during the current crisis. A proper function of lender of last resort and the exceptional measures required by a liquidity trap situation require the central bank to be fully implied in the pursuit of growth and employment; not only of price stability, which remains after all an intermediate objective.

2. ECB Policies at Times of Crisis

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3. A Dual Mandate for the ECB

To summarise, the case for strict inflation targeting appears weak once one admits that monetary policy may have an impact on economic activity, which requires policy makers to arbitrate between sometimes conflicting objectives. Furthermore, the inflation mandate has had an impact on ECB action, regarding both its reactivity (in particular during the crisis), and the transparency of its communication strategy, a crucial element of central banking effectiveness. However, there are at least two other arguments that can be made in favour of adopting a Fed-like dual mandate.

The first is a simple assignment problem. Following Mundell (1961), the task of monetary authorities should be to react to common shocks. The optimal monetary policy response to idiosyncratic shocks is to “do nothing” (Lane 2000), leaving the task to national fiscal policies, that remain decentralised. The strict inflation target, and the absence of a federal government capable of implementing EMU fiscal policies leaves one of the objectives of macroeconomic policy, the reaction to common shocks, without an instrument. Either fiscal policy (through a real EU budget), or monetary policy (through a dual mandate) should be assigned to that objective. Standard textbook analysis actually suggests that a combination of the two would be the most effective.

The second argument is not confined to monetary unions. As the debate between hawks and doves shows, a dual mandate does not necessarily mean insufficient attention to price stability. The dual

mandate was in place when Chairman Paul Volcker conducted a bold anti-inflationary monetary policy in the early 1980s. And just two years ago, in the midst of the financial crisis, Chicago Fed President Charles Evans complained that too much attention were being paid to inflation and public deficits, and concluded that “if 5% inflation would have our hair on fire, so should 9% unemployment.” (Evans 2011). In other words, nothing prevents central banks from fighting inflation in the framework of a dual mandate; but they cannot fight unemployment within inflation targeting. One institutional arrangement may encompass the other through the appropriate choice of weights, but the converse is not true. Once again, the deep justification of exclusive focus on price stability can only lie in the acceptance of a neoclassical platonic world in which macroeconomic policy is ineffective, and hence governments need make no choice.

4. Conclusion

The Eurozone crisis has been the occasion for institutional reform that so far has further strengthened the adherence of EMU governance to the Berlin-Washington consensus. The one major innovation, the Fiscal Compact, has strengthened the constraints on Member States’ fiscal policies. German opposition to any attempt to create transfer mechanisms (be they Eurobonds, a European unemployment subsidy scheme, or a strengthened role for the EU budget) has blocked progress towards a more federal monetary union, endowed with the instruments that are

necessary to avoid systematic divergence. Germany and European institutions promote an economic model based on the compression of domestic demand and export-led growth. This is unlikely to be effective: any large economy needs to strike a balance between external and domestic demand, as has been acknowledged even by the Chinese leadership.

The reform process of EU institutions triggered by the crisis should not be stopped only because so far it took the wrong direction. On the contrary, it should be made more ambitious. Rethinking the ECB's mandate could be an important step forward towards a federal state that today, albeit politically not realistic, seems the only durable solution to European woes.

A more powerful and "political" ECB would of course need to be made more accountable. The tradeoffs implicit in the dual mandate would lead to the choice of specific trajectories with a probable heterogeneous impact across Member States. This explains the resistance of European policy makers to a change the ECB mandate, which could only be overcome by strengthening the central bank's accountability. Taking once again the Fed as a model, this could be made by subjecting the ECB to stricter control by the European Parliament, that as of today has very little say on the ECB action. ■

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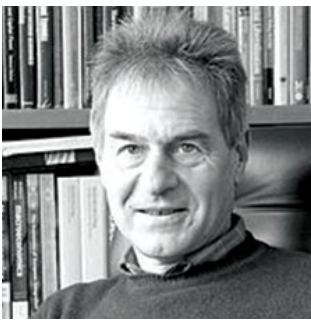
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**DO I LOOK
LIKE I AM
MADE OUT
OF MONEY!?**



The ECB and Unemployment



Charles Wyplosz,
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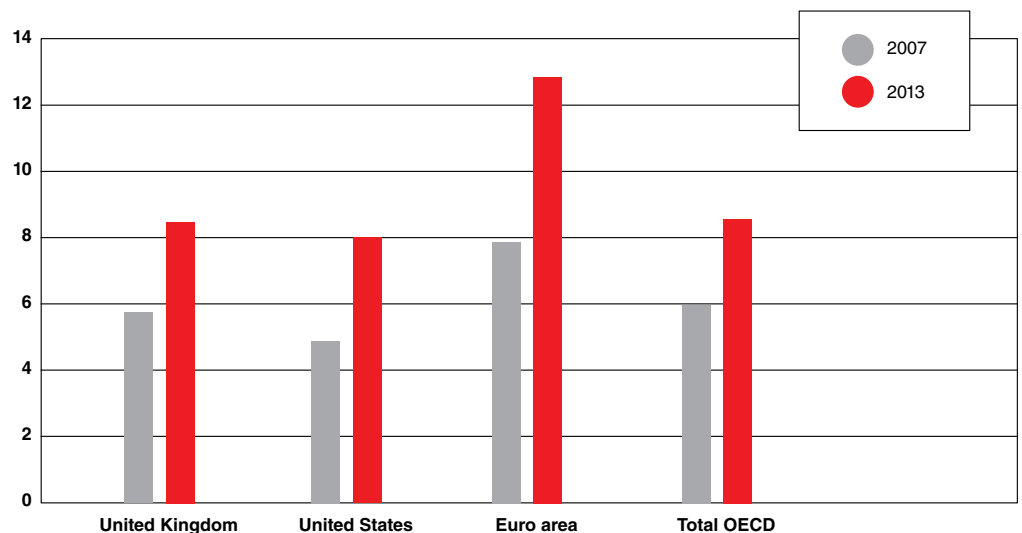
Introduction

The unemployment rate in the Euro area has increased by more than 50% since 2007, starting from an already unacceptably high level. The financial crisis that hit the world in 2007-8 is of historical proportions and explains some of this increase, of course. Figure 1 shows that the decline has been much worse in the Eurozone than in other developed countries that suffered from the financial shock. It is not surprising, therefore, that citizens are asking who is

responsible for this unmitigated disaster? The disaster can be measured in the number of job losses; any amount will conceal the distress experienced by individuals and families which will inevitably have deep and long-lasting political consequences. Moreover, the impact of the financial crisis can be captured by lost revenues which will most likely never be recovered. Essentially we are witnessing a massive theft that dwarfs the biggest criminal operations.



Rates of unemployment in 2007 and 2013



The answer involves two separate questions. First, why did the crisis happen? Second, why were its effects so deep and long lasting? The list of potential culprits includes economists, governments and central bankers. My answer to both questions is that governments have failed their people, nowhere as badly as in the Eurozone.

Economists can be blamed for a poor understanding of economic mechanisms. I have no doubt that, one century from now, future economists will look with scorn at our current level of knowledge, but this is how progress works. Still, we have enough knowledge to understand the crisis and some (including the latest Nobel Prize recipient Robert Shiller) actually described it quite precisely before it occurred. This does exonerate the profession at large, which collectively failed to issue strong warning signals. At least, once the crisis erupted, the profession did suggest policy responses, but disagreements were – and remain – present and made for confusion.

Governments were in charge of banking regulation and supervision. They failed. They were in charge of policy responses and they equally failed, to varying degrees. The situation has been worse in the Euro Area where the financial crisis morphed into a debt crisis, which remains poorly managed. Central banks were also in charge of policy responses. The rest of the paper offers an evaluation of their actions, focusing on the ECB.

Central banks during the crisis

As is well known, central banks have taken extraordinary measures during the crisis. They rapidly reduced their interest rate policies down to the zero lower bound, in an effort to alleviate the contractionary impact of the bank crisis.¹⁵ They also provided ample liquidity to banks in an effort to restart the interbank market, which is where banks borrow from each other to be able to grant loans to households and firms. When this proved insufficient, the central banks lent directly to individual banks; the ECB even committed to provide any amount to banks at a preannounced and very low interest rate. The amounts injected in the economy have been enormous, beyond anything previously done. Figure 2 shows the “size” of the ECB and of the Federal Reserve (the size of their balance sheets) and draws attention to these extraordinary actions.

Figure 2 also shows some important differences between the ECB and the Federal Reserve. While the sizes of liquidity injections are broadly of the same order of magnitude, the timing has been different. The Federal Reserve moved faster and more decisively in September 2008 as Lehman Brothers collapsed. The fact that the crisis originated in Wall Street probably explains the difference. Afterwards, however, the Federal Reserve continued to expand liquidity – a process that it dubbed Quantitative Easing or QE – while the ECB compensated any support to banks by an equal amount of liquidity withdrawal. The ECB explicitly rejected any QE-type policy, even though the economic recovery in the

¹⁵The ECB inopportunately raised its interest rate in June 2008 before realising – but not acknowledging – its mistake.

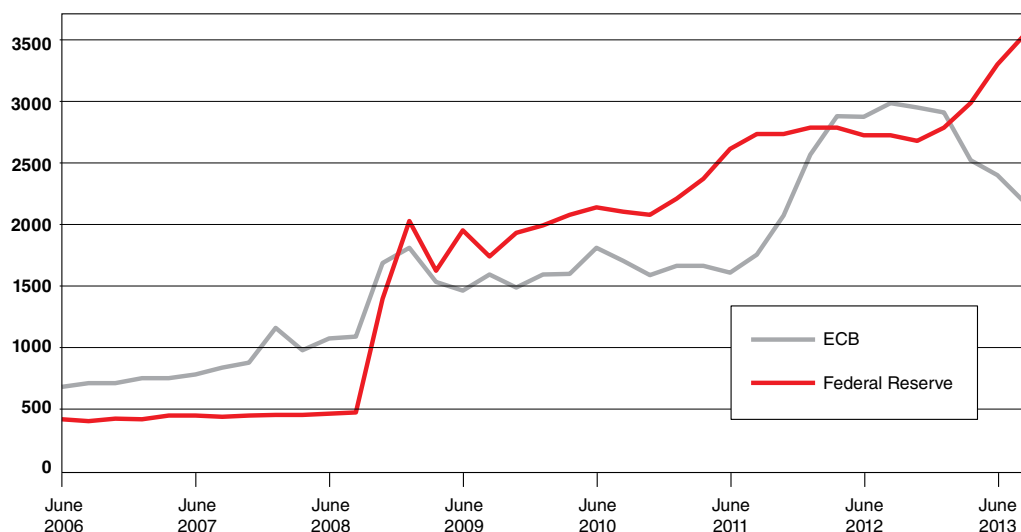
Eurozone lagged behind the US recovery. The onset of the sovereign debt crisis did not elicit a change in the ECB policy, even though the Euro area went into a second recession. It is only when the crisis reached alarming proportions in the second half of 2011 that the ECB started again to expand its liquidity provision programme.

In the US, QE was explicitly designed to support the economic recovery and to bring unemployment back down.

The ECB, on the other hand, has always considered that its policy stance was expansionary enough. Its liquidity provision operations were explicitly designed to support banks in 2008 and to alleviate pressure on public debts in 2011-12. This is why the ECB has always asserted that its actions were not of the QE type. This means that the ECB was, officially at least, not concerned, or much less concerned about rising unemployment than the Federal Reserve.



Size of the central banks (Total assets in billions of respective currencies)



This interpretation is confirmed by the fact that, after June 2012, the ECB has reduced its size, meaning it has reabsorbed about €500 billion. This is the month when the President of the ECB announced the Open Market Transactions (OMT) program, whereby the central bank indicated that it would do “whatever it takes” to limit the interest rates faced by the member countries in crisis. The OMT program is a commitment to backstop public debts with unlimited purchases. It has reduced massively the fears that had dominated the financial markets since early 2010 when the Greek crisis started. Markets reacted immediately. This mere announcement, so far not backed by any action, has proved sufficient to remove the edge of the crisis, at least up to the time of writing. Even though unemployment has continued to rise after June 2012, the ECB has withdrawn some of its liquidity support.

The mandate of the ECB

How to explain this difference in policy actions between the ECB and the Federal Reserve? The usual interpretation refers to the different mandates of the two central banks. The Federal Reserve’s mandate, set by the US Congress, is dual: the central bank is formally required to help achieve “maximum employment” and “stable prices”. The ECB’s mandate, spelled out in the Maastricht Treaty, is different. It sets price stability as the main objective while “supporting the economic policies of the union” is a secondary aim, which can only be considered when price stability is not jeopardised. In that sense, the ECB does not have to act against unemployment if it considers that inflation is a threat.

This interpretation is not fully convincing, however. Early studies, e.g. Ullrich (2003), which have examined the actual behaviour of both central banks before the crisis suggest that they did not act very differently. The ECB was found to react to both inflation and the level of activity. A more recent study that encompasses the financial crisis period (Belke and Klose, 2010) confirms the similarity of behaviour before the crisis but a divergence once the crisis started. The Federal Reserve is found to have become more reactive to the level of activity while the ECB seems to have grown more concerned about inflation. Importantly, the ECB is found to be concerned about credit, which is related to the size of its balance sheet.

These are just initial results, which may not be confirmed by further studies. Yet, they refer to what the ECB calls its monetary policy “two-pillar” strategy. From the start, the ECB has inherited the Bundesbank tradition of concern with inflation, the first pillar, and with the money stock, the second pillar. This strategy, which has been highly controversial (Wyplosz, 2000), can explain Figure 2: the ECB has expanded liquidity as a matter of necessity to contain the crisis, but it is uncomfortable with it. The role of liquidity has been the subject of acute doctrinal debates and the ECB is unique in retaining this pillar.

Conclusion

The rise in Eurozone unemployment is first and foremost driven by the austere fiscal policies adopted since 2010, but the ECB's rejection of QE can be seen as a limitation to its actions toward activity and employment stabilisation. In a way, this is consistent with its mandate, but its pre-crisis behaviour suggests that the ECB has acted de facto like many other central banks, in effect caring about employment. Its actions during the crisis could well be better explained by its stated two-pillar strategy.

This distinction matters greatly. It is most unlikely that the formal mandate of the ECB can be changed, since it would require a new treaty. On the other hand, the two-pillar strategy is purely an internal matter within the ECB and it can be modified without further challenges. This strategy has been heavily criticised and can be seen as reflecting the ancient tradition of the Bundesbank, which has itself increasingly paid less attention to the second pillar. The main obstacle to the adoption of a more up-to-date strategy is that it would explicitly repudiate the intellectual inheritance from the Bundesbank.

Yet the crisis has shown that another pillar, long disregarded by the ECB, is essential. Central banks can no longer underplay their responsibility for financial stability.¹⁶ In fact, the ECB is now in charge of the Single Supervision Mechanism. This calls for a redefinition by the ECB of its monetary policy strategy. It offers a unique opportunity to remove what may have been an internal obstacle to QE and a policy stance more favourable to employment. Experience around the world has shown that this does not have to come at the expense of price stability. ■

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We are witnessing a massive theft that dwarfs the biggest criminal operations.

¹⁶ The former president of the ECB, Jean-Claude Trichet has repeatedly asserted that "the best contribution of the ECB to financial stability is price stability".



Upcoming events

ANNUAL PARLIAMENTARY CONFERENCE

PUBLIC EVENT - EUROPEAN PARLIAMENT, BRUSSELS

WEDNESDAY 4th AND THURSDAY 5th DECEMBER 2013

The first annual Progressive Economy Parliamentary Conference will provide a new opportunity for progressive members of national parliaments and of the European Parliament to jointly debate the policies, challenges and developments in the economic and social fields across Europe, as well as with leading economic experts and other policymakers in an open conference format.

The forthcoming independent Annual Growth Survey (iAGS) report for 2014 will be presented for the first time publicly by its authors during the first half-day conference. The 2014 iAGS will provide analysis, forecasts and policy recommendations on macroeconomic perspectives, rising inequalities in labour markets, wage developments, and proposals in the field of eurozone governance. The second half-day, a conference on the role of tax policy in fighting inequalities and in supporting sustainable growth and jobs will be held with a debate among members of the European and national parliaments and leading experts in this field.

DAY 1: CONFERENCE ON GROWTH AND JOBS

WEDNESDAY 4 DECEMBER 2013, 14.30-18.00

- | | |
|--------------------|---|
| 14.30-14.45 | WELCOME AND INTRODUCTION BY HANNES SWOBODA, PRESIDENT OF THE S&D GROUP |
| 14.45-15.15 | KEYNOTE CONTRIBUTION BY JEAN-PAUL FITOUSSI, PROFESSOR OF ECONOMICS AT LUISS UNIVERSITY, ROME, AND MEMBER OF THE SCIENTIFIC BOARD OF PROGRESSIVE ECONOMY |
| 15.15-15.45 | PRESENTATION OF THE 2014 INDEPENDENT ANNUAL GROWTH SURVEY (iAGS) BY ITS CO-AUTHORS FROM THE OFCE, ECLM AND IMK ECONOMIC INSTITUTES |
| 15.45-16.00 | COFFEE BREAK |
| 16.00-18.00 | POLICY DEBATE - PROSPECTS AND POLICY STRATEGIES FOR GROWTH AND JOBS ACROSS EUROPE AND THE EUROZONE |
- **Karine Berger**, Member of the French National Assembly
 - **Elisa Ferreira**, MEP, S&D Group coordinator on economic affairs
 - **Paolo Guerrieri**, Member of the Italian Senate
 - **Valeriano Gomez**, Spokesperson for the Economic and Monetary Committee in the Spanish Parliament (TBC)
 - **Olli Rehn**, European Commissioner for Economic and Monetary Affairs
 - **Charles Wyplosz**, Professor of Economics at the Graduate Institute, Geneva, and Member of the Progressive Economy Scientific Board

The debate will be moderated by Jacki Davis Managing Director of Meade Davis Communications

DAY 2: CONFERENCE ON TAX AND INEQUALITY

THURSDAY 5 DECEMBER 2013, 9.00-12.30

9.00-10.30 PUTTING A REAL END TO TAX EVASION AND TAX FRAUD! IS THE G20 AGENDA GOOD ENOUGH?

An introductory contribution will be made by Xavier Harel, journalist and author of the TV documentary "Evasion fiscale: Le hold-up du siècle" followed by interventions from the panel:

- **Vieri Ceriani**, Adviser to the Italian Minister of Economy
- **Mojca Kleva**, MEP, EP Rapporteur on tax evasion and fraud
- **Richard Murphy**, Founder of Tax Justice Network and Director of Tax Research
- **Carsten Schneider**, Member of the German Bundestag

An open debate will be moderated by **Jacki Davis**

10.30-12.00 FIGHTING INEQUALITY IN SOCIETY THROUGH TAX POLICY - DEFINING A NEW PROGRESSIVE TAX STRATEGY

An introductory contribution will be made by Professor Thomas Piketty, Paris School of Economics, followed by interventions from the panel:

- **Magdalena Andersson**, Swedish S-D economic affairs spokeswoman
- **Thomas Jensen**, Member of the Danish Parliament
- **Pierre-Alain Muet**, Member of the French National Assembly
- **Ahmed Laaouej**, Member of the Belgian Senate

An open debate will be moderated by **Jacki Davis**

12.00-12.30 CLOSING SPEECH - PAUL MAGNETTE SENATOR AND PRESIDENT OF THE BELGIAN PARTI SOCIALISTE, PS

THIS PARLIAMENTARY CONFERENCE IS TAKING PLACE ON BOTH DAYS IN THE PREMISES OF THE EUROPEAN PARLIAMENT, ROOM P3C050, PAUL HENRY SPAAK BUILDING.

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PROGRESSIVE ECONOMY FORUM 2014

EUROPEAN PARLIAMENT, BRUSSELS

5th-8th MARCH 2014

Europe is still struggling with the crisis which unleashed more than five years ago. Beyond the irresponsible behaviour of large parts of the financial sector, the crisis is rooted in rising inequalities, which the policy of austerity has only deepened, both within and between nation states.

Strong political pressures exerted on wage levels and on essential components of national welfare systems and labour market rules do not only ignore key lessons to be learnt from the crisis, they also turn a blind eye to ever stronger scientific evidence on the positive economic role played by more equal income distribution or good healthcare systems.

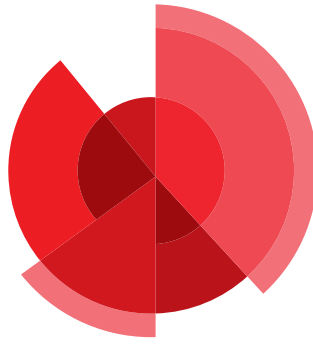
Inequality will therefore be the leading theme of the 2014 Progressive Economy Forum. The aim of the Forum meeting is to explore and to develop progressive scientific and political thinking and actions to respond to the challenge of inequality and to help building more equal, and therefore better functioning, societies.

The Forum provides a unique opportunity for progressives across communities, and engaged in addressing economic and social challenges in various ways, to be involved in both scientific and political dialogues geared at reinforcing and at promoting progressive ideas at national, European and global levels.

The Forum includes a Scientific Conference on 5-6 March and a Political Conference on 7-8 March.

For more information and registration see:

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