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Editorial

Andreas Breinbauer
Head of the FH Supervisory Council, University of Applied Sciences bfi Vienna

Dear reader,

The latest issue of our series is called “Europe in Crisis: Challenges and Scenarios for Cohesion”, and is dedicated to the Jean Monnet Conference which was held on February 10-11 2015 at the University of Applied Sciences bfi Vienna.

First of all, **Johannes Jäger** and **Elisabeth Springler** provide an overview of the contributions and discussions given at the Jean Monnet Conference. In their paper there is a short summary of central theoretical insights and key-issues raised at the conference. Moreover, an introduction to the contributions is provided, and conclusions are summarized.

In the first article, **Eckhard Hein** and **Daniel Detzer** outline alternative policy recommendations addressing the problems of differential inflation, divergence in competitiveness and associated current account imbalances within the Euro area. The authors provide a basic framework to systematically address the related issues, and based on this framework, they outline the required stance for alternative economic policies. Furthermore, they discuss the implications for alternative monetary, wage/incomes and fiscal policies in the Euro area as a whole as well as the consequences for structural and regional policies in the Euro area periphery in particular.

Following this, **Philip Arestis** deals with the “sustainability of the euro”. He begins by examining the theoretical underpinnings of the EMU model and the requirements for effective monetary union. He then addresses the problems with the current EMU arrangements along with the nature of the reforms implemented and their impact on the operations of the euro area. His conclusion is anything but a bright future outlook for the sustainability of the euro.

Furthermore, in his article, **Thanos Skouras** addresses the subject of “Europe’s failing”, and points out that Europe is entering its fifth year of weak growth and high unemployment. In his opinion, the crisis in which Europe and particularly the Eurozone are enmeshed is not due to excessive sovereign debt, but due to current European leadership. Referring to this, the main objective of the author is to answer ten relevant questions to prove his thesis.

The next article, written by **Ana Podvršič,** is about spatialisation strategies of capitalist accumulation in Slovenia’s post-Yugoslav development. She states that continuous economic growth, political stability, and a neo-corporatist system are some of the factors mentioned most frequently when one talks about Slovenia‘s post-socialist transition. The author focusses on the different right-wing and leftist discourses regarding the Slovene economy, and, in contrast to these views, she argues that it is necessary to situate the development of Slovene capitalism within the broader process of the “making of the EU post-socialist periphery”. She proposes to combine three analytical perspectives, identifying two mechanisms of the hierarchical structuration of national economies within the EU, and analysing the Slovene spatialisation strategies. The conclusion provides insight into how the crisis further reveals the European peripherisation of the capitalist economy of Slovenia.

Finally, **Jon Las Heras'** argues that European organised labour needs to set a historical inflexion point so that the current global neoliberal mode of regulation can be overcome. He starts off with a historical explanation on the transformation of western countries towards a global neoliberal mode of regulation; and goes on to describe organised labour´s reactions against globalisation pressures at corporate level as well as the problems that such workers have encountered in order to construct an effective counter-hegemonic movement in Europe. He then concludes by arguing that current trade union initiatives are not sufficient to regain the ground that has been lost and may reproduce more of the same.

I wish you, dear readers, an interesting read, and we look forward to receiving your feedback!

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Johannes Jäger / Elisabeth Springler

Europe in Crisis: Challenges and Scenarios for Cohesion

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'Europe will be forged in crises, and will be the sum of the solutions adopted for those crises'
(Jean Monnet)

Abstract

The aim of this paper is to provide an overview of the contributions and discussions at a conference, which was part of an Erasmus+ Jean Monnet Project and took place at the University of Applied Sciences bfi Vienna from February 10th to February 11th, 2015. The conference and this special issue deal with challenges and scenarios for cohesion in the current European crisis. We intend to outline central theoretical insights and issues raised at the conference. Moreover, the contributions to this special issue are introduced and the conclusions are summarized.

1. Introduction

In February 2015, a conference co-financed by the European Union as part of an Erasmus+ Jean Monnet Project took place at the University of Applied Sciences bfi Vienna (see www.europe-in-crisis.eu). More than 100 scholars, students, policy makers and civil society representatives from many European countries participated in this conference. The main discussions centered on the general theme related to challenges and scenarios for cohesion in Europe. Firstly, this short paper seeks to provide a very brief overview of the theoretical background and important empirical insights of the discussion. Secondly, we briefly introduce central findings documented in this special issue based on selected papers presented at the conference. Finally, we draw some conclusions regarding scenarios for cohesion.

2. Theoretical perspectives and empirical insights

Under the headings of *'concepts of cohesion and cohesion of concepts'* and *'economies in turbulent times request new proposals for future European integration',* the scene for research on European cohesion was set with the first two sessions. Traditional neoclassical economic approaches and common Dynamic Stochastic General Equilibrium Models frequently used by policy makers tend to be of very limited value to understand the 2008 economic and financial crisis (e.g. Tovar 2009, Del Negro 2015). In addition, the flaws of varieties of capitalism approaches and mainstream European integration literature have been documented very well by numerous authors (Bruff 2011, Van Apeldoorn/Drahokoupil/Horn 2009, Nousios/Overbeek/Tsolakis 2012, Ryner 2012). Due to their different scope and methodology, critical political economy and post-Keynesian perspectives are more promising approaches to understand the European crisis and to provide a framework for the discussion of cohesion and possible scenarios in Europe. Both approaches represent important alternatives or heterodox perspectives in social sciences and economics (for an overview see: Jäger/Springler 2012).

Critical political economy stands in the tradition of classical political economy. It analyses the economy as part of society and provides a framework for an integrative analysis of the economy and political processes (Shields/Bruff/Macartney 2011). For this reason, it can be considered a pre- but at the same time a post-disciplinary perspective (Jessop/Sum 2001). At the core of critical political economy, there is a class-based framework for the analysis of society, which aims at contributing to emancipatory struggles and overcoming specific historical forms of capitalism such as the current neoliberal European mode of production. This makes it an important source to discuss the inter-related economic and political reasons for the crisis in Europe and the hitherto undertaken anti-crisis measures. Post-Keynesianism goes back to the very roots of Keynes and contradicts the assumption of perfect markets, full employment, and inter-temporal equilibria. It deals with real world phenomena such as unemployment and stagnating economies. Post-Keynesian approaches in addition to Keynes combine elements of classical political economy, institutionalist approaches and often concentrate on explicitly criticizing neoclassical perspectives, the financial sector and economic policy based on neoclassical theory such as the current economic policy in the European Union (cf. EuromemoGroup 2014). These central features make both, critical political economy and post-Keynesianism, not just highly useful but complementary approaches.

In addition to the need for alternative theoretical perspectives in general, the third session on *‘European cohesion requests a new coordinated approach to diminish uneven development within European Union member states’* addressed questions related to uneven development and asymmetric relations in Europe. These elements were considered crucial not just because development is highly unequal in Europe and relationships are highly asymmetric (Jäger/Springler 2015) but also because the recent crisis has deepened the rift between the core and the periphery within Europe. This is a development which can be explained very well by going back to the rich tradition of dependency theory within critical political economy (Becker/Jäger/Weissenbacher 2015).

Given these uneven and asymmetric features of the European crisis, session four on *‘The challenges European Institutions are confronted with and how to overcome them’* dealt with political dynamics of crisis management. As Bieling (2015) and Oberndorfer (2015) have pointed out, the crisis responses have led to a consolidation of authoritarian neoliberalism at the level of the European Union. As this does not solve the fundamental problems of European integration, it can be considered a ‘passive revolution in trouble’. For the moment these developments make emancipatory policies very difficult and unlikely to be successful. Additionally, Wigger (2015) emphasises that the obsession with competitiveness puts another institutional constraint to potentially progressive solutions to the European crisis.

The final sessions on *'Evoking European Institutions and agents'* and the closing *round table discussion* with policy makers and civil society representatives attempted to bring together different agents' perspectives. As Horn/Clua-Losada (2015) show, this is very challenging given the heterogeneity and the weakness of labour in Europe. It can be concluded that due to the structural problems within the European Union and the prevailing asymmetric power relations at different spatial levels, progressive developments are rather unlikely, at least in the short-run. As we have shown elsewhere (Jäger/Springler 2015), a continuation of a muddle-through policy is the most likely scenario. However, this approach tends to increase multiple contradictions.

3. Challenges and scenarios for cohesion

While the first two papers of this special issue are based on post-Keynisan perspectives and address the problems at the level of the European Union and demand specific alternative policies in order to achieve cohesion, the following papers focus on selected aspects of the dynamics of the political economy within Europe. They show how and why structures and specific interests impede progressive solutions to the European crisis and make cohesion so difficult to achieve.

The first paper in the special issue is provided by *Eckhard Hein and Daniel Detzer.* In their extensive contribution, they provide very detailed reasons for current imbalances in Europe and ways to solve these problems. The authors outline in detail how alternative economic policies at the European level in the fields of monetary policy, incomes policy and fiscal policy could help to end the European crisis and to achieve cohesion.

This is followed by a contribution by *Philip Arestis* on the sustainability of the Euro. In his paper, he argues that that the theoretical underpinnings of the European Monetary Union were highly problematic and that an effective monetary union requires different institutional arrangements. In addition, the author identifies the problems of the current arrangements related to the Euro adopted during the crisis. Hence, he stresses the importance of a different monetary policy but also the need for different fiscal policies and monetary policy co-ordination.

In the third contribution, *Thanos Skouras* shows very clearly that the problem in Europe is not excessive sovereign debt as preached by political discourses inspired by neoclassical economic theory but complacent leadership. In particular, Germany's self-seeking stance is considered to be the key-problem that prevents progressive crisis solutions, which could potentially aim at social cohesion. From a slightly different theoretical perspective, his insights are strikingly close and complementary to other Critical Political Economy perspectives such as the one by Cafruny (2015) who discusses the role of Germany from a geopolitical perspective.

The following paper is provided by *Ana Podvršič,* the winner of the best-poster-award at the conference. In her paper, she analyses the spatialization strategies of capitalist accumulation in the case of Slovenia. The approach is based on a labour-centred perspective to capitalist development, critical theory of international relations, and the dependency school. With her innovative approach, she shows very clearly how the crisis further tends to deepen the peripherisation of the Slovenian economy. This underlines the difficulties peripheral countries face within the current neoliberal European crisis mode of integration.

Jon Las Heras, another poster presenter, focuses on labour strategies in his contribution. He analyses the transformation of the labour process within the context of global neoliberal regulation in the automotive sector. By linking the theoretical perspective on global value chains with the transnational coordination of European Industrial Relations, he provides a very innovative and insightful approach to the analysis of progressive strategies of labour within the context of the European crisis from a global perspective. However, his contribution also shows the difficulties of progressive strategies.

4. Conclusions

Based on the discussions at the conference and the papers published in this special issue, we conclude that the European crisis has made evident and deepened the problems related to a neoliberal mode of integration in the European Union. This has caused growing divergence and increased inequality between different social groups, countries and regions in Europe. While common neoclassical approaches and mainstream integration literature have severe difficulties to explain this, critical political economy and post-Keynesian perspectives allow understanding the causes of these processes. The conference and the papers published in this special issue impressively show why and how such alternative perspectives are necessary in order to foster cohesive developments in Europe. However, the analyses also show that processes which may promote noteworthy advances of cohesion are not yet at the horizon. On the contrary, divisions at different scales and of different types are still on the rise.

5. Acknowledgements

We wish to thank all those who participated in the conference. In particular, we wish to thank those who presented a paper or a poster and who prepared a comment and contributed to the very promising discussions. We are very grateful to all those who made their contribution available for being published in this special issue. We also wish to thank Johannes Wetzinger for supporting us with all tasks related to the EU funding and the conference web page as well as Jürgen Rasteiger for his local organizing support, Caroline Sander and Katharina Nowotny for their assistance in editing this special issue and Martin Buxbaum, Katharina Gröblinger, Victoria Kohoutek and Margit Ozvalda for lecturing all the papers. Finally we wish to thank Helmut Holzinger for encouraging us to apply for this project and the European Union for the financial support of the conference and the present publication.

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Eckhard Hein / Daniel Detzer

Coping with imbalances in the Euro area: Policy alternatives addressing divergences and disparities between member countries

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Abstract

In this paper we outline alternative policy recommendations addressing the problems of differential inflation, divergence in competitiveness and associated current account imbalances within the Euro area. The major purpose of these alternative policy proposals is to generate sustainably high demand and output growth in the Euro area as a whole, providing high levels of non-inflationary employment, as well as preventing 'export-led mercantilist' and 'debt-led consumption boom' types of development, both within the Euro area and with respect to the role of the Euro area in the world economy. Making use of Thirlwall's (1979, 2002) model of a 'balance-of-payments-constrained growth rate' (BPC-GR), we provide a basic framework to systematically address the related issues. Based on this framework, we outline the required stance for alternative economic policies and then discuss the implications for alternative monetary, wage/incomes and fiscal policies in the Euro area as a whole, as well as the consequences for structural and regional policies in the Euro area periphery in particular.

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Preliminary versions of this paper were presented at conferences in Bilbao, Warsaw, Berlin and Athens in 2014, and in Vienna in 2015. We are grateful to the participants, in particular to Jerome Creel, for helpful comments and to Jeffrey Althouse and Enisa Serhati for research and editing assistance. Remaining errors are, of course, ours.

1. Introduction

In this paper we outline alternative policy recommendations addressing the problems of differential inflation, divergence in competitiveness and associated current account imbalances within the Euro area. The major purpose of these alternative policy proposals is to generate sustainably high demand and output growth in the Euro area, providing high levels of non-inflationary employment, as well as preventing 'export-led mercantilist' and 'debt-led consumption boom' types of development, both within the Euro area and with respect to the role of the Euro area in the world economy. These types of development, generated by 'finance dominated capitalism', shaped the global and Euro area economies before the crisis, and they have each proven unsustainable (Hein 2012, 2013, 2013/14, Hein/Dodig 2014). This paper builds on the analysis of the origins of intra-Euro area imbalances and on the overview of the unsuccessful policy responses to these imbalances in the companion papers by Carasco/Peinado (2014) and Dodig/Herr (2015a).

To motivate and structure our overview of policy alternatives, we start with Thirlwall's (1979, 2002) model of a 'balance-of-payments-constrained growth rate' (BPCGR). This model allows the causes of current account imbalances and the role of inflation differentials and differential competitiveness to be systematically identified, and appropriate policy implications to be developed. We will build on initial attempts at applying this concept to the analysis of intra-Euro area imbalances and drawing economic policy implications in Hein (2012, Chapter 8) and Hein/Truger/van Treeck (2012), and will further refine and develop this analysis here, comparing the economic policy suggestions with those provided by other authors with similar objectives and intentions. In Section 2 we will be presenting the theoretical framework, i.e. Thirlwall's BPCGR, and adjust it towards the conditions of a currency union, which will allow us to study the relationships between current account imbalances and price and non-price competitiveness in a consistent and systematic way. In Section 3 we will then outline the broad economic policy implications deriving from this framework which are meant to promote sustainable non-inflationary full-employment growth within the Euro area on the one hand, and to avoid unsustainable current account imbalances within the Euro area but also with respect to the role of the Euro area as a whole in the world economy on the other. Section 4 will then be devoted to a more precise discussion of an alternative coordinated macroeconomic policy mix for the Euro area, which is understood as a policy package that would have to be jointly implemented. First, we will discuss the role of monetary policies and of the ECB, arguing that it should guarantee public debt of member countries and target low interest rates, in particular, as well as contribute to stabilising the financial sector. Second, we will turn to wage and incomes policies and argue that their main target should be to stabilise nominal unit labour cost growth, and thus inflation rates, across the Euro area, at some target rate, thus contributing to constant and stable functional income distribution as a 'by-product'. Third, we will outline the role of fiscal policies which we believe shall stabilise the economy at non-inflationary, full-employment output levels with more or less balanced current accounts in the short and in the long run. For each of these policy areas we will first outline the general tasks of policy-making within the broad economic policy mix; we will then specify these tasks and instruments for the conditions of the Euro area; we will address the respective contributions to rebalancing the Euro area; and we will finally touch on alternative suggestions by other authors. Against this background, we will then, in Section 5, turn to the discussion of some ideas to re-structure the countries of the periphery, and the crisis countries in particular, to facilitate medium- to long-run catching up with the more mature countries of the Euro area core. Section 6 will briefly summarise and conclude.

2. Theoretical framework

To frame and structure our discussion of policy alternatives addressing divergence and disparities between Euro area member countries regarding current account balances, inflation and trends in competitiveness, we have chosen Thirlwall's (1979, 2002) model of a 'balance-of-payments-constrained growth rate' (BPCGR) as a starting point. This model allows for a systematic and consistent discussion of the interrelationships between current account balances, inflation differentials and non-price competitiveness. Applying this model to a currency area yields the following determinants of the BPCGR for a single country, as shown in Appendix A:[1]

$$(1) \qquad \hat{Y}_d^b = \frac{(1+\eta+\psi)(\hat{p}_d - \hat{p}_f) + \varepsilon \hat{Y}_f}{\pi}, \qquad \eta, \psi < 0, \quad \varepsilon, \pi > 0 ,$$

where $\hat{Y}_d^b$ is the BPCGR for the domestic economy, $\hat{Y}_f$ is the foreign real GDP growth rate, i.e. the growth rate of the rest of the Euro area since its current account with the rest of the world was roughly balanced before the financial, economic and euro crises and should remain in balance in the future, $\hat{p}_d$ is domestic inflation, $\hat{p}_f$ is foreign inflation, i.e. inflation in the rest of the Euro area, η is the price elasticity of the demand for exports, ψ is the price elasticity of the demand for imports, ε is the income elasticity of the demand for exports and π is the income elasticity of the demand for imports. Disparities in ε and π among countries are considered to reflect differences in non-price competitiveness. With given foreign GDP growth and given foreign inflation, the BPCGR of a single economy can be improved by lower domestic inflation, provided that $1+\eta+\psi<0$, i.e. the Marshall-Lerner condition, holds, by a higher income elasticity of domestic exports, or by a lower income elasticity of domestic imports.

Applying the model to the member countries of the Euro area means that each of the member countries should grow at its BPCGR, i.e. avoid current account surpluses and current account deficits, but without taking the BPCGR as exogenously given, as will be explained below. In principle, each of the countries should also target the same rate of inflation and thus equalise domestic and foreign inflation. This is so because a rate of inflation below the foreign rate will mean a higher BPCGR of the country under consideration; it implies, however, a lower BPCGR of the other countries of the Euro area, provided that its current account with the rest of the world is roughly balanced. Following the rule of equal inflation rates across the member countries of the currency union therefore implies that the BPCGR for each of the member countries would become:

$$(2) \qquad \hat{Y}_d^b = \frac{\varepsilon \hat{Y}_f}{\pi} = \frac{\hat{X}}{\pi}.$$

1 McCombie (2002: 15) nicely summarises the balance of payments constrained growth model as follows: "The central tenet of the balance-of-payments-constrained growth model is that a country cannot run a balance-of-payments deficit for any length of time that has to be financed by short-term capital flows and which results in an increasing net foreign-debt-to-GDP ratio. If a country attempts to do this, the operation of the international financial markets will lead to increasing downward pressure on the currency, with the danger of a collapse in the exchange rate and the risk of a resulting depreciation/inflation spiral. There is also the possibility that the country's international credit rating will be downgraded. Consequently, in the long run, the basic balance (current account plus long-term capital flows) has to be in equilibrium. An implication of this approach is that there is nothing that guarantees that this rate will be the one consistent with the full employment of resources or the growth of productive potential."

Note that with balanced current accounts within the currency area, and with equal rates of inflation, the GDP growth rates of member countries may nonetheless differ, depending on the relative income elasticities of demand for exports and imports. Also note that improving the BPCGR of a single country within a currency area by means of increasing the income elasticity of exports or by reducing the income elasticity of imports has the adverse effect on the BPCGR of the rest of the currency area, because this will mean increasing its income elasticity of imports and decreasing the income elasticity for its exports – always assuming a roughly balanced current account of the currency area with the rest of the world.

Since according to equation (1) Thirlwall's BPCGR, applied to a currency union (without any internal nominal exchange rates), is determined by inflation differentials, provided that the Marshall-Lerner condition can be assumed to hold, by the income elasticities of the demand for imports and exports, and by the rate of real GDP growth of the trading partners, we can identify several causes for current account imbalances in a currency union.

The first and general one is, of course, GDP growth differentials between the different Euro area member countries exceeding those implied by their respective BPCGRs. These will be associated with a deterioration of the current account position in the countries growing 'too fast', and an improvement in the countries growing 'too slowly'. From an economic policy perspective, we can distinguish two different causes for countries growing 'too fast' relative to their BPCGR – catch-up processes associated with high investment in productive capital on the one hand, and bubble-induced growth associated with asset and/or housing price booms and high investment in real estate and/or high debt-financed consumption on the other. Whereas the former should be welcomed from an economic policy perspective aiming at "promot[ing] economic, social and territorial cohesion, and solidarity among Member States" (Treaty on European Union, Article 3.3), the latter should be avoided by appropriate economic policies and institutions.

From another angle we could also argue that the BPCGRs are 'too low' or 'too high' given the actual or trend growth rates of the respective economies. The first reason for this could be too high inflation differentials, which cause a 'too low' or 'too high' BPCGR for the respective countries, given their actual growth differentials. A major cause for inadequate inflation differentials is, of course, differentials in unit labour cost growth, but changes in mark-ups in firms' pricing as well as differentials in the development of other input costs must also be taken into account. A second cause is related to quality competitiveness and hence the income elasticities of exports and imports. For given growth differentials within a currency union, we will observe current account imbalances if income elasticities of demand for exports of rapidly growing catching-up countries are 'too low' and income elasticities of demand for imports are 'too high', thus reducing the BPCGR below the actual growth rate. Slowly growing mature economies will contribute to imbalances if the reverse holds true, that is if there are 'too high' income elasticities of the demand for their exports and 'too low' income elasticities of their demand for imports, hence lifting the BPCGR above the actual growth rate.

3. The general stance required for policy alternatives

From this perspective, economic policies would generally have to focus on generating high, non-inflationary demand growth in the Euro area as close as possible to the Euro area BPCGR on the one hand, and to improve non-price competitiveness with respect to the rest of the world in order to lift the Euro area BPCGR on the other. Furthermore, preventing 'export-led mercantilist' and 'debt-led consumption boom' types of development, which dominated the Euro area before the crisis, is of utmost importance, both within the Euro area but also with respect to the role of the Euro area as a whole in the world economy. To rebalance the Euro area internally, economic policies would have to focus on the mutual adjustment of actual growth rates of member countries and the respective BPCGRs. In the short run, this means stimulating aggregate demand and growth in the current account surplus countries relative to the Euro area average trend, and dampening aggregate demand and growth relative to the Euro area average trend in the current account deficit countries. Lowering unit labour cost growth and inflation relative to the Euro area average trend in current account deficit countries, avoiding deflation and demand-depressing effects of redistribution at the expense of the labour income share and low income households, and increasing unit labour cost growth and inflation in current account surplus countries will contribute to this effort – lifting the respective BPCGRs for current account deficit countries and lowering it for current account surplus countries. Improving non-price competitiveness of current account deficit countries relative to current account surplus countries will have the same effect via the respective income elasticities of demand for imports and exports. However, these are rather medium- to long-run economic policy targets as they involve process and product innovations as well as structural changes in the respective economies.

Finally, even if the Euro area were successful in developing and applying appropriate policies in line with these targets, we should not expect perfectly balanced current accounts of member countries, neither in the short, nor in the long run, in particular due to necessary catching-up processes. This implies that the catching-up countries will have a tendency to grow above their BPCGRs, whereas the mature countries will tend to grow below their respective BPCGRs. For this reason, the Euro area will have to develop a stable financing mechanism for the associated current account deficits of catching-up member countries. As we show in Appendix B, as long as the current account deficit country, i.e. the catching-up country in the Euro area, is growing sustainably faster than the mature current account surplus country, there is no risk of exploding net foreign debt-GDP ratios in the current account deficit country. And provided that the GDP growth rate in the current account deficit country exceeds the rate of interest on net foreign debt, the stabilisation of the net foreign debt-GDP ratio is perfectly compatible with a trade deficit of the current account deficit country, as we also show in Appendix B.

If we include a constant and sustainable net inflow of long-term capital (C), the BPCGR from equation (1), as shown in Appendix A, turns to:

$$\hat{Y}_d^b = \frac{(1+\theta\eta+\psi)(\hat{p}_d-\hat{p}_f)+\theta\varepsilon\hat{Y}_f+(1-\theta)(\hat{C}-\hat{p}_d)}{\pi}, \tag{3}$$

with θ as the share of export revenues in total receipts to pay for imports, (1-θ) as the share of net capital inflows, and $\hat{C}$ as the growth rate of net capital inflows, measured in domestic currency, required to finance persistent current account deficits. With equal rates of inflation across the currency area, this would become:

$$\text{(4)} \qquad \hat{Y}_d^b = \frac{\theta\varepsilon\hat{Y}_f + (1-\theta)\left(\hat{C} - \hat{p}_d\right)}{\pi} = \frac{\theta\hat{X} + (1-\theta)\left(\hat{C} - \hat{p}_d\right)}{\pi}.$$

Comparing equation (4) with equation (2) shows that net capital inflows lift the BPCGR of the current account deficit country if the growth rate of these inflows in real terms, taking into account domestic inflation, exceeds the growth rate of exports, or the growth rate of foreign GDP multiplied by the income elasticity of exports.

4. More concrete policy proposals for the Euro area

It is obvious – and has been developed extensively in the companion paper by Dodig/Herr (2015a) – that the current economic policy framework of the Euro area is inappropriate to deal with the requirements outlined above.[2] In fact, the current policy framework and the stance of the policies applied have even reinforced current account imbalances through different channels. First, they have been unable to prevent significant inflation differentials to emerge within the Euro area, mainly by undermining the conditions for effective wage bargaining conditions as a main tool for this. Second, they have not provided the appropriate tools for domestic demand management to adjust the actual growth rate of each country towards the BPCGR, mainly by applying a ‘one size fits all’ policy with respect to government budget balances and government debt in the context of the Stability and Growth Pact (SGP). Third, due to the lack of any consistent industrial and development strategy for the Euro area as a whole and for the catching-up countries in particular, ensuring that capital inflows into these countries support long-run sustainable growth, they have not provided any effective policy tools to adjust the BPCGR of the high-growth current account deficit countries towards the respective growth rates.

Therefore, alternative policy proposals would have to remedy these deficiencies, aiming at non-inflationary full-employment growth in the Euro area as a whole, as well as in each of its member countries, with sustainable current account deficits/surpluses in the member countries – and a roughly balanced current account for the Euro area as a whole to contribute to balanced growth of the world economy. Preliminary outlines based on general post-Keynesian macroeconomic models with the respective implications for the macroeconomic policy mix (Arestis 2013, Hein/Stockhammer 2010, 2011) have been presented in Hein (2012, Chapter 8, 2013, 2013/14), Hein/Truger (2005, 2007, 2011) and Hein/Truger/van Treeck (2012), among several others. We will build on these approaches.

2 See also the contributions by Arestis (2011), Arestis/Sawyer (2011), De Grauwe (2011a, 2013), Hein/Truger (2005, 2011), and Hein/Truger/van Treeck (2012), among several others.

Before we start, it should be pointed out that the suggestions for monetary, wage/incomes, fiscal and industrial/regional policies outlined below should be understood as a policy package that would have to be implemented in a coordinated way – the main reason being that policy makers and their instruments do not affect just one target variable (employment, growth, inflation, external balance) but impact several targets in the short and in the long run. Coordination means intra-coordination of national as well as European institutions within the respective policy area and inter-coordination among these areas of policy making at national and European levels in particular.[3] For this, the Macroeconomic Dialogue and a completely revamped European Semester following and applying the policy mix to be outlined below could provide the institutional framework.

4.1 Monetary policy

First, central banks' interest rate policies should abstain from attempting to fine-tune unemployment in the short and inflation in the long run, as suggested by New Consensus Macroeconomics (NCM).[4] Varying interest rates have cost and distribution effects on the business sector which may be effective in achieving inflation targets in the short run, in particular if the economy is facing accelerating inflation. With accelerating inflation, increasing the base rate of interest under the control of the central bank will ultimately also make credit and financial market rates rise and will be able to choke off an investment boom. But if accelerating disinflation, and finally deflation, prevail, monetary interest rate policies will be ineffective: first, due to the zero lower bound of the nominal interest rate; second, due to rising mark-ups in the setting of interest rates in credit and financial markets by banks and financial intermediaries because of increasing risk and uncertainty premia; and third, due to interest rate inelasticities of firms' real investment in a disinflationary or deflationary climate. Further on, in the long run rising interest rates – applied successfully to stop accelerating inflation in the short run – will again feed conflicting-claims inflation because the price setting of surviving firms will have to cover higher interest costs.

Therefore, central banks, and hence the ECB, should focus on targeting low real interest rates in credit and financial markets as included in the mandate for the US Federal Reserve (Meyer 2001) in order to avoid unfavourable cost and distribution effects on firms and workers while favouring rentiers.[5] A slightly positive long-term real rate of interest below the long-run rate of productivity growth seems to be a reasonable target. Rentiers' real financial wealth will be protected against inflation, but a redistribution of income in favour of the productive sector and at the expense of the rentiers will take place, which should be favourable for real investment, employment and growth. Furthermore, central banks have to act as a 'lender of last resort' in periods of liquidity crisis, and they should be involved in the regulation and supervision of financial markets. This includes the definition of credit standards for refinance operations with commercial banks, the implementation of compulsory reserve requirements for different types of assets to be held with the central bank,

3 See Hein/Truger (2005), as well as the contributions in Hein et al. (2005) for conceptual considerations in this respect.

4 For NCM see Clarida/Gali/Gertler (1999) and Goodfriend/King (1997); for detailed critiques of NCM see Arestis (2009), Arestis/Sawyer (2004a), and Hein/Stockhammer (2010).

5 See Rochon/Setterfield (2007) for a review of post-Keynesian suggestions regarding the 'parking it' approach towards interest rate policies of central banks and the rate of interest central banks should target.

and even credit controls to channel credit into desirable areas and to avoid credit-financed bubbles in certain markets (De Grauwe 2011b, Detzer 2012, Palley 2004, 2010).

Most importantly, in the present situation the ECB should not only act as a lender of last resort for the banking system, it should also guarantee public debt of the Euro area member countries in a convincing and unconditional manner, acting as a lender of last resort to the governments, too.

"National governments in a monetary union issue debt in a 'foreign' currency, i.e. one over which they have no control. As a result, they cannot guarantee to the bondholders that they will always have the necessary liquidity to pay out the bond at maturity. This contrasts with 'stand alone' countries that issue sovereign bonds in their own currencies. This feature allows these countries to guarantee that the cash will always be available to pay out the bondholders. Thus in a stand-alone country there is an implicit guarantee that the central bank is a lender of last resort in the government bond market" (De Grauwe 2011b:2).

As a lender of last resort for member country governments, the ECB would allow member countries to issue debt in their 'own currency', which would immediately reduce the pressure imposed by financial markets on those countries presently in crisis, allowing these countries to regain fiscal sovereignty.[6] It would thus provide the conditions for a long-run oriented solution to the current account imbalances within the Euro area, as we will explain in the following sections.

In July 2012 the ECB took a major step in this direction when ECB President Mario Draghi (2012) announced that "(w)ithin our mandate, the ECB is ready to do whatever it takes to preserve the euro". However, this was later specified such that the ECB's willingness to intervene into secondary government bond markets in the context of Outright Monetary Transactions (OMT) was made conditional on the respective country applying EFSF/ESM macroeconomic adjustment programmes (ECB 2012).[7] This link is detrimental to recovery in the crisis country and to rebalancing the Euro area at high levels of economic activity, because imposing fiscal austerity policies on the countries in question will make the downswing worse (as it did in 2012/13), will lead to the (threat of) deflationary stagnation and will not bring government debt-GDP ratios down, as has been observed in the course of the euro crisis (De Grauwe 2011a, Hein 2013/14).[8]

6 According to De Grauwe (2011a), a 'bad equilibrium', characterised by high interest rates, recessionary forces, increasing budgetary problems and increasing probability of insolvency, would be prevented.

7 'A necessary condition for Outright Monetary Transactions is strict and effective conditionality attached to an appropriate European Financial Stability Facility/European Stability Mechanism (EFSF/ESM) programme. Such programmes can take the form of a full EFSF/ESM macroeconomic adjustment programme or a precautionary programme (Enhanced Conditions Credit Line), provided that they include the possibility of EFSF/ESM primary market purchases. The involvement of the IMF shall also be sought for the design of the country-specific conditionality and the monitoring of such a programme.' (ECB 2012)

8 According to the May 2014 update of the European Commission (2014) AMECO database, of the 12 initial and core Euro area member countries, in the forecast for 2014 only Germany, Austria, Belgium and France will have recovered and exceeded their respective 2007 real GDP levels, whereas Greece, Ireland, Spain, Italy, Portugal, the Netherlands and Finland, as well as the EU12 as a whole will still remain well below their 2007 levels. In 2014 Greece will suffer from deflation, and Ireland, Spain, Portugal, Italy, the Netherlands and Belgium will be facing severe deflationary risks, with inflation rates (well) below one percent. Government debt-GDP ratios for 2014 are projected to decline only in Germany, Ireland and Portugal, whereas the other countries will have to face further rising ratios.

Therefore, Hein (2013/14) has argued that the ECB could simply announce that it will intervene unconditionally into secondary government bond markets as soon as the nominal rate of interest on government bonds (i) exceeds the long-run nominal rate of growth of the respective country j, i.e. the sum of real GDP growth ($\hat{Y}_j$) plus the rate of inflation ($\hat{p}_j$):

(5) $$i_j \leq \hat{p}_j + \hat{Y}_j .$$

This would imply country-specific caps on nominal interest rates on government bonds (and to the extent that government bond yields are a benchmark also for long-term interest rate in the respective countries in general), making sure that long-term real interest rates do not exceed real GDP growth trends. If government deficits or debt were inflationary – which would have to be prevented by wage and fiscal policies, as will be addressed below – governments would automatically be punished by the ECB tolerating a higher nominal long-term interest rate as per this rule. This is not, and should not be, an inflation targeting strategy. De Grauwe (2011b) has suggested a similar rule, arguing that the ECB should commit itself to providing unlimited liquidity as soon as the government bond rate of a specific country exceeds the risk-free rate – which is considered to be the rate on German government bonds – by 200 basis points to prevent moral hazard. However, this seems to be more arbitrary and less focused than the approach taken by Hein (2013/14).

The suggestions outlined here differ from the proposals for 'eurobonds' of different types focusing on joint guarantees for only parts of member countries' government debt (Brunnermeier et al. 2011, De Grauwe/Moesen 2009, Delpla/von Weizsäcker 2010, European Commission 2011, Palley 2011).[9] Although these suggestions can be considered steps in the right direction, they still include major parts of member countries' government debt that are not backed by the ECB and hence remain susceptible to financial market speculation. Even worse are suggestions for 'eurobonds' that are combined with fixed rules for government debt repayment (SVR 2011) because they do not acknowledge the macroeconomic role of government deficits and debt, as we will outline below.

4.2 Wage and incomes policy

In an alternative macroeconomic policy mix, incomes and wage policies should take responsibility for nominal stabilisation in particular, that is, for stable inflation rates. In the end, accelerating inflation always is the result of unresolved distribution conflicts. If the distribution claims of firms, rentiers, the government and the external sector are constant, nominal wages should rise according to the sum of long-run economy-wide growth of labour productivity plus the inflation target. A reduction of the other actors' claims, however, would allow for an increase in nominal wages exceeding this benchmark. Applying this norm to the Euro area means that nominal

9 See Bibow (2013) for a short overview and assessment.

wages should rise according to the sum of long-run average growth of labour productivity in the national economy plus the target rate of inflation for the Euro area as a whole:

$$(6) \qquad \hat{w}_j = \hat{y}_j + p^T,$$

with $\hat{w}$, $\hat{y}$ and p^T denoting nominal wage growth and labour productivity growth in country j as well as the inflation target for the Euro area as a whole. Following such a wage norm would contribute to equal inflation rates across the Euro area, assuming mark-ups and unit non-wage costs in pricing to be roughly constant. This would prevent improving the BPCGR of a single country at the expense of the rest of the Euro area and would thus also prevent mercantilist strategies based on nominal wage moderation in general.

To contribute to rebalancing the current accounts within the Euro area at high levels of economic activity by means of re-adjusting relative price competitiveness, wage policies would have to deviate from the norm outlined above for an intermediate period. Nominal wage growth in current account surplus countries would have to exceed the norm, whereas nominal wage growth in the current account deficit countries would have to fall short of this norm. Stockhammer/Onaran (2012) have suggested a simple macroeconomic wage rule for the EU, which we adapt for the Euro area:

$$(7) \qquad \hat{w}_j = \hat{y}_j + p^T + \alpha\left(ULC_{EA} - ULC_j\right),$$

where ULC denotes nominal unit labour costs in the Euro area (EA) and in country j. The inflation target would have to be set such as to avoid deflation in all countries, which means it would have to be raised above the current level of 'below, but close to two per cent'.

To achieve the nominal wage growth targets, a high degree of wage bargaining co-ordination at the macroeconomic level and organised labour markets with strong labour unions and employer associations seem necessary conditions.[10] Government involvement in wage bargaining may be required, too. In particular, in countries with highly deregulated labour markets and increasing dispersion of wages, minimum wage legislation will be helpful for nominal stabilisation at the macroeconomic level apart from its usefulness in terms of containing wage inequality. Furthermore, legal extensions of wage bargaining results throughout the whole industry or sector and other extension mechanisms, as well as public sector bargaining setting the pattern for private sectors, could also be helpful.

For the Euro area and the European Union this implies that the prevalent and dominating orientation of labour market and social policies towards deregulation and flexibilisation of labour markets, nominal and real wage restraint and falling wage shares as previously enshrined in the Employment Guidelines, the Broad Economic Policy Guidelines and now in the Country Specific Recommendations of the European Semester and the Memoranda of Understanding with the

10 See Hein (2002) and Schulten (2002) for reviews of the theoretical and empirical literature on related macroeconomic and industrial relations.

crisis countries[11] will have to be abandoned in favour of re-organising labour markets, stabilising labour unions and employer associations, legal extensions of collective wage bargaining results, Euro area-wide minimum wage legislation, and so on. This could provide the institutional requirements for effective implementation of wage policies stabilising inflation at the target rate as well as stabilising functional income shares, ceteris paribus. On the one hand, this would imply supporting and encouraging attempts of European trade unions (and employer associations) at cross-border coordination of wage bargaining along these lines.[12] On the other hand, this could be supported by coordinated minimum wage policies in the EU and the Euro area. The European Trade Union Confederation (ETUC 2012) has recommended setting the minimum wage at a level of at least 50 per cent of the average wage or 60 per cent of the median wage in the respective member countries.[13] Following this idea, OFCE/IMK/ECLM (2013, Chapter 3) suggest that unless collective wage-setting institutions are strong and coverage is high (as for example in Austria), statutory minimum wages should be introduced in those countries where they do not yet exist. These minimum wages should then be adjusted by reflecting productivity growth and the current account balance – assuming that the latter is relevantly affected by price competitiveness. To contribute to internally rebalancing the Euro area, it is suggested that only countries with roughly balanced current accounts raise the minimum wage according to the inflation target (which is assumed to remain at 2 per cent). Current account deficit countries, however, should only raise it by 1 per cent and current account surplus countries by 3 per cent. However, we would argue that such an approach only makes sense if the long-run productivity growth trend in each country is included, as this would ensure that relative nominal unit labour cost growth contributes to rebalancing price competitiveness.

Although wage bargaining coordination along the lines outlined above will have some merits in terms of reducing inequality within member countries, preventing further downward pressures on labour income shares exerted by competitive wage policies and beggar-thy-neighbour strategies, and harmonising inflation rates across the Euro area, we would not expect too much in terms of rebalancing the current accounts within the Euro area. Applying vector autoregression analysis on quarterly data for Euro area member countries (1975-2005), Arghyrou/Chortareas (2008: 752) find that “relative incomes have been playing a more prominent role than real exchange rates in long-run current account determination. This implies that the current account deterioration observed in countries such as Greece and Spain following the introduction of the euro is mainly due to higher than average growth rates.” This finding is well in line with a conclusion drawn by the European Commission (2010: 10), which argues with regard to Euro area member countries that “[a] large part of the cross-country divergence in the current account since the late 1990s is rooted in domestic demand factors. [...] Stronger relative demand pressures in a given Member State tend to fuel import demand and depress the current account. [...] Differences in export performance – and therefore price competitiveness – also contributed to the divergence of current

11 See ETUI (2014, Chapters 2-5) and Schulten/Müller (2013) for accounts of the most recent developments in wage bargaining, employment and inequality in the EU.

12 See Schulten (2005) for a pre-crisis review of European trade unions’ attempts at coordinating wage bargaining aiming at real wage growth in line with national trend labour productivity growth and at preventing beggar-thy-neighbour policies based on wage dumping.

13 See also Schulten (2012) for an elaboration on European minimum wage policy.

accounts but, in most Member States, this was of second order compared with domestic demand factors." In their panel estimations for the Euro area member countries (1995-2012), Carasco/ Peinado (2014) find some effects of real GDP growth differentials relative to average Euro area growth, indicating catching-up factors, and of nominal unit labour cost growth differentials, indicating divergent price competitiveness, on the current account balance, which however become smaller if only the pre-crisis period (1999-2010) is considered. Furthermore, they find a considerable structural component in their estimations, considered to represent the effects of a country's industrial structure and non-price competitiveness on its current account. For Germany, as the main current account surplus country, Schröder (2011) and Storm/Naastepad (2014) have only found small effects of price competitiveness on the German trade balance. In their estimations, the development of the German trade balance is almost completely explained by foreign demand relative to domestic demand dynamics. Interestingly, these findings seem broadly in line with those by Kollmann et al. (2014) based on an estimated Dynamic Stochastic General Equilibrium (DSGE) model with three 'countries': Germany, the rest of the Euro area and the rest of the world (1995-2013).[14] All this evidence seems well in line with Thirlwall's (2002: 78) conclusion that "(t)he only sure and long-term solution to raising a country's growth rate consistent with balance of payments equilibrium on current account is structural change to raise ε [the income elasticity of the demand for exports] and to reduce π [the income elasticity of the demand for imports]". This seems to also be true for countries within a currency union, in which nominal exchange rate adjustments to counter divergences in inflation rates are no longer available.

Furthermore, if we do not only focus on the link between wage bargaining, nominal unit labour cost growth, inflation and price competitiveness, but take into account that applying the nominal wage growth rule in equation (7) might have effects on functional income distribution as well, contributing to rebalancing current accounts, we have to acknowledge that these effects are small. Applying standard estimations for the propensities to save from wages and profits from the respective econometric literature, Hein/Truger (2014a, 2014b) have recently shown that the labour income share in Germany would have to rise to levels not seen in post-World War II German history to boost private consumption and allow for both, 1) a nearly balanced government budget respecting the newly introduced German Debt Brake, and 2) a balanced current account at given high levels of aggregate demand, output and employment.

All of this implies that the major burden for internally rebalancing the Euro area should fall on fiscal policies, adjusting the actual growth rate towards the BPCGR in the short run, and on structural and regional policies, raising the BPCGR in the periphery in the medium to long run.

14 "Our findings are consistent with the view that adverse shocks to domestic demand were key drivers of the surplus, especially after the mid-2000s. Our analysis also supports the official German view that strong external demand and German competitiveness gains (wage moderation and technological improvements) were important sources of the German external surplus. However, strong external demand and German competitiveness gains explain, at most, 1/3 to 1/2 of the surplus; strong external demand mattered mainly before the financial crisis, while wage restraint induced by labour market reforms contributed to the German surplus after the mid-2000s. The relative role of these factors has thus varied greatly across time. Positive shocks to the German saving rate have been especially important since the mid-2000s." (Kollmann et al. 2014: 4)

4.3 Fiscal policy

In a coordinated policy mix, fiscal policies should take over responsibility for real stabilisation, full employment and also a more equal distribution of disposable income. This has several aspects. By definition the excess of private saving (S) over private nominal investment (p_dI) at a given level of economic activity and employment has to be absorbed by the excess of nominal exports (p_dX) over nominal imports (p_feM) – including the balance of primary income and the balance of income transfers, thus the current account balance – plus the excess of government spending (G) over tax revenues (T):

$$S - p_d I = p_d X - p_f eM + G - T. \tag{8}$$

Therefore, with balanced current accounts ($p_d X - p_f eM = 0$), government deficits in the long-run perspective (D) have to permanently take up the excess of private saving over private investment to assure a desired high level of employment:

$$D = G - T = S - p_d I. \tag{9}$$ [15]

As is well known from Domar (1944) and shown in Appendix C, a constant government deficit-GDP ratio (D/Y^n) with a constant and positive long-run nominal GDP growth rate ($\hat{Y}^n$) will make the government debt-GDP ratio (B/Y^n) converge towards a definite value in the long run:

$$\frac{B}{Y^n} = \frac{\frac{D}{Y^n}}{\hat{Y}^n}. \tag{10}$$

Therefore, there will be no problem of accelerating public debt-GDP ratios. Furthermore, as shown in Appendix C, nominal interest rates falling short of nominal GDP growth and hence of tax revenue growth (or low real interest rates falling short of real GDP growth) will prevent that government debt services redistribute income in favour of rentiers, which would be detrimental to aggregate demand and growth.[16] That is why targeting low interest rates on government bonds by the central bank is so important for our policy package.

Permanent government deficits should be directed towards public investment in a wider sense (including increasing public employment), providing the economy with public infrastructure and public education at all levels (kindergartens, schools, high schools, universities) to promote structural change towards an environmentally sustainable long-run growth path. Apart from this permanent role of government debt, which also supplies a safe haven for private saving and thus stabilises financial markets, counter-cyclical fiscal policies – together with automatic stabilisers

15 This is, of course, the 'functional finance' view pioneered by Lerner (1943). See also Arestis/Sawyer (2004b).

16 See Hein (2014, Chapter 9) for the effects of interest rates and interest payments in post-Keynesian/Kaleckian distribution and growth models. Although theoretically under certain conditions higher interest rates and re-distribution towards rentiers may have expansionary effects, empirically these have not been found so far.

– should stabilise the economy in the face of aggregate demand shocks. From these considerations we get the following requirements for fiscal policies:

$$(11) \qquad D = D_L + D_S\left(Y^T - Y\right), \qquad D_S > 0,$$

with D_L as permanent government deficit (or surplus), which is required to keep output at non-inflationary full employment target (Y^T) in the long run, the government deficit (surplus) balancing the private sector surplus (deficit) with a roughly balanced current account, and D_S as the reaction in the case of short-run deviations of output from target. It has to be added that due to labour market persistent/hysteresis mechanisms and the effects of government investment on productivity growth, the non-inflationary full employment level of output itself is not independent of government expenditures, and of government investment in a broader sense in particular (Hein/Stockhammer 2010); and of course, well-functioning wage bargaining coordination applying the norm developed in the previous sub-section will support high (and increasing) levels of non-inflationary employment.

Furthermore, governments should apply progressive income taxes, relevant wealth, property and inheritance taxes, as well as social transfers aiming at redistribution of income and wealth in favour of low income and low wealth households. On the one hand, this will reduce excess saving at non-inflationary full employment and thus stabilise aggregate demand – without generating problems of unsustainable indebtedness for private households or the foreign sector. Progressive income taxation and relevant taxes on wealth, property and inheritance thus also reduce the requirements for government deficits. On the other hand, redistributive taxes and social policies will improve automatic stabilisers and thus reduce fluctuations in economic activity and the required size of short-run discretionary stabilising fiscal policies.

Applying this approach to the Euro area would require the Stability and Growth Pact and its further 'developments' in the course of the crisis to be abandoned: the 'Six-Pack', the 'Two-Pack', the Euro-Plus Pact, the Fiscal Compact, and the austerity policies imposed on the crisis countries. Each of these coordinating tools focuses on variables which governments cannot directly control (deficit-GDP ratio, debt-GDP ratio). The attempts at achieving the targets for these variables have imposed a restrictive and deflationary stance on the Euro area, have prevented the recovery of the crisis countries in particular, and caused another Euro area recession in 2012/13 (Hein 2013/14, Zezza 2012).

Hein (2012, Chapter 8; 2013/14), Hein/Truger (2007) and Hein/Truger/van Treeck (2012) have therefore suggested replacing these means of coordinating national fiscal policies by a different method that focuses on variables governments can control and allows coordinated fiscal policies to be implemented along the requirements for short- and long-run real stabilisation at non-inflationary full employment and roughly balanced current accounts outlined above. They have suggested the coordination of long-run expenditure paths for non-cyclical government spending, i.e. those components of spending which are under control of the government. The sum of these expenditure paths should be geared towards stabilising aggregate demand in the Euro area at non-inflationary full employment levels, and automatic stabilisers plus discretionary counter-cyclical fiscal policies could be applied to fight demand shocks. For each member country this would mean that on average over the cycle and the average net tax rate in each member country given, as a first approximation the path for non-cyclical government expenditure should generate a 'structural' government deficit/surplus, balancing the 'structural' private sector surplus/deficit at high levels of non-inflationary employment and a roughly balanced current account.[17] This would ensure that on average over the cycle GDP growth is close to the BPCGR of each individual country. Cyclical deviations would be dampened by automatic stabilisers and, if required, by discretionary fiscal expansion/contraction. As shown above, the government debt-GDP ratios associated with such a strategy will not explode, and the ECB keeping nominal interest rates in each country below trend nominal GDP growth of the respective country will ensure that debt services will not have restrictive distributional effects, as shown in Appendix C. That is the reason why coordination, here between fiscal and monetary policies, is so important for this approach. The expenditure paths for non-cyclical public sector spending of each member country should be coordinated and monitored by the European Commission, and unwillingness to correct deviations should ultimately be sanctioned.

Following these recommendations would mean a significant contribution towards internally rebalancing the Euro area and preventing increasing current account imbalances for the future. The current account surplus countries would have to apply more expansionary fiscal policies than hitherto, both before the crisis and since, to increase domestic demand growth. Together with temporary acceptance of higher than Euro area average inflation rates, this would adjust their actual growth to their BPCGRs. This would also lift foreign growth for all current account deficit countries as well as foreign inflation and therefore raise their BPCGR towards their actual rate of growth, thus contributing to allowing the current account deficit countries to reduce their deficits. Current account deficit countries have two options. They can make use of highly restrictive fiscal policies to adjust their actual rate of growth towards their BPCGR – in fact, the austerity policies that the crisis countries were particularly forced to implement as a precondition for financial rescue measures can be considered a version of this. Alternatively, and more favourably, current account deficit countries, perhaps with the exception of Ireland,[18] should aim at actively improving their BPCGR. Such a policy should be actively encouraged with external assistance from the EU itself. This means, on the one hand, contributing to a reduction of the inflation differentials with respect to the surplus countries by means of unit labour cost growth below the sum of national trend productivity growth plus the inflation target, as we have argued above, avoiding deflation and redistribution at the expense of the wage share and of low income households. On the other hand, current account deficit countries would have to increase the income elasticity of demand for their exports and to reduce the income elasticity of demand for imports by means of industrial,

17 If the growth rate associated with a balanced current account deviates from the one associated with stable inflation employment, governments will face a short-run trade-off. However, prioritizing the achievement of the BPCGR over the growth rate associated with stable-inflation employment would generate mutual adjustment processes: rising (falling) inflation rates reducing (raising) the BPCGR on the one hand, and endogeneity processes with respect to the stable-inflation rate of employment via labour market persistence mechanisms etc. on the other.

18 In the case of Ireland, the current account deficit was not due to a deficit in external trade but rather a deficit in the flows of primary incomes. Ireland shows huge surpluses in the balance of goods and services, which, however, fell short of the net payment commitments associated with the negative balance of primary incomes.

structural and regional policies; this means they have to improve their non-price competitiveness. We will address the related issues of this strategy, which should be the most promising in the long run, in the next section.

As already mentioned in Section 3, due to necessary catching-up processes in a still quite heterogeneous currency area with respect to per-capita income in particular, we would not expect perfectly balanced current accounts of Euro area member countries in the medium to long run. This means that the catching-up countries will have a persistent tendency to grow above their BPCGRs, whereas the mature countries will tend to grow below their respective BPCGRs. Coordinating fiscal policies by means of expenditure paths for non-cyclical government spending and target 'structural' public sector deficits/surpluses should therefore take tolerable current account deficits associated with catching-up processes into account. On the one hand, this means allowing for more expansionary/less restrictive fiscal policies than described in equation (9) for high growth catching-up countries, taking into account acceptable current account deficits. On the other hand, this implies that fiscal policies in the slow growth mature economies could be less expansionary/more restrictive than described by equation (9). As we show in Appendix B, as long as the current account deficit country, i.e. the catching-up country in the Euro area, is growing sustainably faster than the mature current account surplus country, there is no risk of exploding net foreign debt-GDP ratios in the current account deficit country. Furthermore, as we also show in Appendix B, with a constant current account deficit-GDP ratio ($\Delta L_d / Y_d^n$) and constant nominal GDP growth ($\hat{Y}_d^n$), the net foreign liabilities-GDP ratio (L_d / Y_d^n) of a current account deficit country will converge towards a constant value as well, i.e. the growth rates of foreign liabilities and nominal GDP will be equal ($\hat{Y}_d^n = \hat{L}_d$):

$$(12) \qquad \hat{Y}_d^n = \hat{L}_d = \frac{\Delta L_d}{L_d} = \frac{\frac{\Delta L_d}{Y_d^n}}{\frac{L_d}{Y_d^n}} \qquad \Rightarrow \qquad \frac{L_d}{Y_d^n} = \frac{\frac{\Delta L_d}{Y_d^n}}{\hat{Y}_d^n}.$$

Furthermore, the higher the (sustainable!) growth trend of the catching-up economy, the higher the tolerable current account deficit-GDP ratio will be for a given maximum net foreign liabilities-GDP ratio. Finally, as we also show in Appendix B, provided that the rate of interest on net foreign debt remains below the nominal rate of growth of the economy, catching-up countries can afford a constant trade deficit-GDP ratio to be financed by capital inflows without violating a constant net foreign liabilities-GDP ratio.

The coordination of fiscal policies in the Euro area would thus not have to require or target perfectly balanced current accounts and would not have to strictly follow equation (9). Sustainably higher growth in the respective current account deficit country than in the surplus countries on Euro area average should therefore be the ultimate criterion for tolerable current account deficits in the coordination process of fiscal policies. The direction and use of the related net capital imports should be part of an industrial and regional development strategy aiming at facilitating catching up, as will be discussed in the next section. Current account deficits of countries with a below surplus country average GDP growth rate and the related current account surpluses should not be tolerated and should be tackled symmetrically, i.e. by deficit and surplus countries, with the measures discussed above, i.e. with wage and fiscal policies in the short run and with industrial and regional policies in the long run.

As an alternative to these country-specific rules for fiscal policies in conjunction with country-specific assessments of current account deficits/surpluses, Dullien (2010) and Dullien/Schwarzer (2009) have proposed a 'one size fits all' External Economic Stability Pact for the Euro area countries allowing for external deficits or surpluses of 3 percent of GDP each. For deficit countries this would stabilise net foreign debt at 60 percent of GDP, for surplus countries the net foreign assets-GDP ratio would also become 60 percent, assuming that trend nominal GDP growth amounts to 5 percent each. In a similar vein, Horn et al. (2010) have suggested using maximum current account deficits and surpluses of 2 percent as a guideline for fiscal policy coordination in the Euro area. The advantage of these suggestions over present regulations is that they imply symmetric adjustment obligations for deficit and surplus countries. However, provided that a maximum net foreign debt-GDP- or net foreign assets-GDP-ratio is considered a useful target, the proposed target or threshold ratios for current account deficit- or surplus-GDP-ratios would have to be differentiated for individual countries as tolerable current account deficits should be based on different growth dynamics, as can be seen in equation (11). In Appendix B we also show that with different growth dynamics, foreign liabilities-GDP ratios of current account deficit countries and foreign assets-GDP ratios of current account surplus countries cannot be stabilised simultaneously.

The alternative to coordinating member countries' national fiscal policies along the sketched guidelines would be the introduction of a relevant EU or Euro area federal budget, which could assume the required real stabilisation functions to provide high non-inflationary employment in the short and in the long run for the Euro area as a whole and to internally rebalance the currency union. This would mean further political integration, as demanded by Arestis/Sawyer (2013, Chapters 8-9) without spelling out any details. However, several suggestions in this area have been made recently.

The suggestions by the European Commission (2012a, 2012b) and the President of the European Council (van Rompuy et al. 2012) for a EU or Euro area 'fiscal capacity' builds on enforcement of the ill-guided and currently failing policies of fiscal austerity and 'structural reforms' aimed at flexibilisation, liberalisation and constraining workers' and trade unions' bargaining power. The proposed 'fiscal capacity' is mainly meant to operate like an insurance system for country-specific shocks. It is financed by member state budgets, which would also be the beneficiaries in the insurance case. The European Commission (2012a) suggestion also includes the possibility for the 'fiscal capacity' to borrow beyond its own resources, combined with a 'debt redemption fund' for member country debt as proposed by the German Council of Economic Experts (SVR 2011). Since these suggestions are deeply linked with current austerity and structural reform policies, Bibow's (2013: 36) conclusion that "the main purpose of the envisioned fiscal capacity appears to be that of promoting structural reform in economies in crisis" can hardly be escaped.[19]

A cyclical stabilisation insurance fund to cope with country-specific shocks, and with the asymmetric effects of a single monetary policy, which are considered to be the more important ones, is also the first element of the suggestion by the Tommaso Padoa-Schioppa Group (2012: 5), following the credo "that the single currency requires as much fiscal federalism as necessary for its appropriate functioning, but as little as possible." This insurance fund should be created outside the EU budget, remain under direct control of national parliaments, would work in an automatic fashion and would not lead to long-term transfers in only one direction. Second, the group suggests the creation of a European Debt Agency, which would provide a flexible refinancing possibility to countries in distress in exchange for a stepwise transfer of sovereignty applying the principle "sovereignty ends when solvency ends" (Tommaso Padoa-Schioppa Group 2012: 7). Since countries will lose budgetary sovereignty as soon as they run into problems (or exceed the 60 percent threshold government debt-GDP-ratio), the built-in incentives towards restrictive fiscal policies in times of crisis are detrimental to our requirements for fiscal policies outlined above.

Another more promising insurance fund idea also aiming at avoiding permanent one-directional transfers is the Euro area unemployment insurance suggested by Dullien (2013) and Dullien/Fichtner (2013), which is included as a variant for the Euro area 'fiscal capacity' in van Rompuy et al. (2012) as well. Such an unemployment insurance fund could dampen the results of asymmetric shocks across member countries of the Euro area and, provided that temporary deficits are accepted, it could also provide cyclical stabilisation over time, even in case of symmetric shocks. However, by design, an unemployment insurance scheme can neither provide stabilisation of aggregate demand in the Euro area beyond the trade cycle, nor, according to the authors, is the scheme meant to contribute to overcoming the structural imbalances in the Euro area that have contributed to the crisis. And, of course, this suggestion does not tackle the institutional problem facing the Euro area: the separation of fiscal authorities and the central bank, which we have highlighted above.

To deal with this fundamental flaw of Euro area economic policy institutions, and to provide long-run stabilisation of aggregate demand for the Euro area as a whole, Bibow (2013) has suggested a Euro Treasury. This new institution is neither meant to mutualise public debt nor to provide permanent transfers to member countries; "instead, the Euro Treasury is established as a means to pool eurozone public investment spending and have it funded by proper eurozone treasury securities" (Bibow 2013: 1). The basic idea is to separate the public capital budget from

19 Two quotations shall suffice to support this conclusion:
"Building on the Convergence and Competitiveness Instrument, the fiscal capacity for the euro area should be further enhanced. It should be autonomous and rely solely on own resources. It should provide sufficient resources to support important structural reforms in a large economy under distress." (European Commission 2012b: 3).
"Establishing a well-defined and limited fiscal capacity to improve the absorption of country-specific economic shocks, through an insurance system set up at the central level (…) would improve the resilience of the euro area as a whole (…). A built-in incentives-based system would encourage euro area Member States eligible for participation in the shock absorption function to continue to pursue sound fiscal and structural policies in accordance with their contractual obligations. Thereby the two objectives of asymmetric shock absorption and the promotion of sound economic policies would remain intrinsically linked, complementary and mutually reinforcing." (van Rompuy et al. 2012: 5)

the current budget, and to have the former financed by government debt whereas the latter should be financed by taxes, at least on average, over the trade cycle. Bibow (2013) suggests pooling the capital budget at the Euro area level and having it financed by issuing Euro Treasury securities, and to leave current public budgets at the member country level and require balance over the trade cycle. Member countries would have to agree on Euro area-wide public investment expenditure, Bibow suggests three percent of GDP, and the respective growth rate for the following years; the Euro Treasury would issue debt accordingly and allocate the financial means to member countries in line with their (moving average) shares in Euro area GDP.[20] The ECB would have to guarantee the liquidity of Euro Treasury securities. The Euro Treasury would need the power to tax in order to pay interest on its debt or it would have to receive earmarked tax revenues from member countries, with taxes of member countries also being proportional to their share in Euro area GDP and public investment. The Euro Treasury would thus have no re-distributional (transfer) purposes, and it would have to be separated from the EU or Euro area current budget which would have to be balanced on average over the cycle and which could be used for transfer purposes among member countries. A member country's non-compliance with the rule of balanced current public budgets over the trade cycle would be sanctioned by means of withholding investment finance.

Bibow (2013) acknowledges that his Euro Treasury will not provide active counter-cyclical fiscal policies but rather long-run steady investment expenditures. Counter-cyclical fiscal policies are delegated to automatic stabilisers provided by member country public budgets and increase room of manoeuvre for stabilisation due to declining debt services – member countries' current public budgets would only have to be balanced on average over the cycle: "The Euro Treasury would leave the main fiscal stabilization responsibility at the national budget level, where large in-built automatic stabilizers exist" (Bibow 2013: 45). One may wonder whether this is sufficient in deep recessions like 2008/9, when government deficit-GDP ratios for the (original) Euro area (EA-12) exceeded six percent and for single countries reached double-digit values, and how coordination and prevention of free-riding within the Euro area should be organised. However, Bibow has a solution for this, recommending an increase in deficit-financed investment expenditure in case of a severe and symmetric downturn (of for example more than three percent of GDP). More importantly, Bibow's Euro Treasury suggestion does not provide any solution to overcome current (or prevent future) imbalances within the Euro area. For this, Bibow refers to proper nominal wage policies in member countries providing nominal unit labour cost growth and inflation in line with the Euro area target rate, following the rules we have outlined above. However, as we have argued above, on the one hand this may seriously overrate the relevance of price competitiveness for persistent current account imbalances and it may underrate the (future) requirements for capital transfers to improve non-price competitiveness and catching-up processes in the periphery, contributing to the re-balancing of current accounts. Therefore, only if Bibow's Euro Treasury approach is extended and developed towards full-fledged fiscal federalism, with a relevant centralised budget, with the ability to issue debt and to tax in order to manage aggregate demand at the

20 With long-run nominal GDP growth at 5 percent, the public debt-GDP ratio for the Euro area as a whole would stabilise at 60 percent. And with balanced current government budgets of member countries, member country debt-GDP ratios would converge towards zero.

Euro area level, as well as with a functioning transfer system to deal with structural and regional imbalances and the required catching-up processes, will it be able to meet the requirements we have outlined for fiscal policies in our alternative approach. And only with these amendments and developments will this centralised approach towards fiscal policy be superior to the coordinated decentralised approach we have recommended. One may speculate which approach then requires a higher commitment to further political integration of the Euro area.

5. Industrial restructuring and sustainable catching up of the periphery

As argued above, it is likely that due to their higher growth potential the catching-up countries will be exceeding their BPCGRs as determined in equations (1) and (2) and will run into current account deficits, which then need to be financed by capital imports – thus lifting the BPCGR in line with equations (3) and (4). To finance a smooth catching-up process by capital inflows, several prerequisites will have to be met. On the one hand, the capital inflows should be long-term and stable to contribute to financing a catching-up process that will not be disrupted or undermined by the instabilities of financial markets and financial flows as witnessed during the Asian crisis in the late 1990s (Krugman 2000), the Latin American debt crisis in the early 1980s (Dodig/Herr 2015b), or the current euro crisis. However, the stabilisation of capital inflows as such may not be sufficient. As has become clear during the recent crisis, the sustainability of a growth process financed by capital inflows hinges largely on the type of domestic expenditure that is financed. For the future, bubble growth financed by capital imports should be prevented, capital inflows should be focused on productivity enhancing investment and the development of export capacities, and they should be integrated into a European regional and industrial development strategy. We will briefly touch on each of these issues in what follows.

5.1 Efficient regulation of and selective interventions into capital flows

First, there is a case for strict financial regulation to avoid unsustainable housing, construction and consumption booms, which have caused the recent crisis. Measures should address demand- and supply-side factors of unsustainable booms. Policies should thus aim at preventing unsustainable speculative asset price increases as well as at limiting financial sector possibilities to lend recklessly. Access to credit for consumptive purposes should be restricted so that only sustainable debt relations are incurred. On a micro-prudential level, a range of rules could be established. For example, granting loans for consumption or real estate acquisitions should be strictly based on disposable income and not on collateral values. For real estate financing, conservative loan-to-value ratios and sufficiently high equity stakes should be applicable. Loans for speculative purposes should also be strictly limited, etc.

These micro-prudential measures need to be complemented by appropriate macro-prudential tools. With the recent EU capital requirements regulations, new instruments have been introduced. The flexibility package establishes a systemic risk buffer on the national level. It can be used to address exposures in specific markets and increases the equity that needs to be held against such exposures. Additionally, higher risk weights or lower limits for certain loans can be employed as possible tools (Detzer/Herr 2014, Chapter 6.4). At the EU level, the systemic risk board has been established, which monitors and analyses the build-up of systemic risk and is able to act via the ‘comply or explain’ mechanism (Deutsche Bundesbank 2012). While both developments are desirable improvements, there are still severe flaws. National measures, for example, are mostly based on capital requirements. However, the effects of these on containing bubbles are not well known and may vary over time (Detzer 2012). Additionally, national regulators may be reluctant to use those tools to interrupt a prosperous boom. The systemic risk board, at the EU level, may be able to alleviate this problem, but without own tools at hand, its capacities are limited. Therefore, further instruments at the EU or Euro area level seem to be required. One possible instrument that could be used in the Euro area is asset-based reserve requirements. Their effect is relatively easy to determine and they can drive up credit interest rates in specific markets without changing the rest of the interest rate structure.[21] In addition to this, direct credit controls could be applied to keep a credit-driven bubble in check when price-based measures are not sufficiently effective.

5.2 Industrial and regional policy strategy

Second, to achieve a sustainable catching-up process lifting the respective BPCGRs the crisis countries need to develop their productive capacities, increase productivity and improve export capacities. Following Botta (2014), such a strategy should have a strong regional character, because the conditions in the catching-up countries widely differ.[22] For example, Ireland already benefits from a highly developed and dynamic manufacturing sector geared towards exports and a share of manufacturing in GDP at the same level as Germany. However, export-oriented manufacturing would have to be linked more closely with the regional base. In Spain and Portugal the share of manufacturing in GDP has been declining considerably, but it is still higher than in France or the UK. However, manufacturing lacks technological dynamism, innovation and export orientation. Greece suffers from extremely weak manufacturing, as well as from a lack of technological dynamism and export orientation.[23]

Generally, EU industrial and regional policies should promote ‘high road competitiveness’ based on high-quality manufacturing production as the driver of growth instead of relying on a low-wage, labour-intensive development strategy (Aiginger 2014, Simonazzi/Ginzburg/Nocella 2013). As a general rule for development, Thirlwall/Pacheco-López (2008, Chapter 5) argue that countries

21 For an overview of asset-based reserve requirements see Palley (2004, 2010); for their application to address asset price bubbles and their superiority to capital requirements see Detzer (2012).

22 For reviews of the state of development of industry structures, productivity and trade relationships within the EU and the Euro area, as well as the implications for industrial policies, see the different perspectives in Aiginger (2012, 2013, 2014), Botta (2014), Pawlicki/Stobbe (2012), Pianta (2014), Reinstaller et al. (2012), Simonazzi/Ginzburg/Nocella (2013) and Stöllinger et al. (2013), for example. On the general revival or return of industrial policy, see Aiginger (2014) and Wade (2012).

23 According to Aiginger (2014), in 2012 the following percentage shares of manufacturing in GDP could be observed: Germany: 20, France: 8.9, UK: 8.9, Italy: 14, Ireland: 21, Spain: 12.2, Portugal: 12.2, Greece: 8.6. See Aiginger (2013, 2014) for a detailed study on the structure and development of manufacturing, export capacities etc. in the periphery countries.

should try to expand their capacities in exports that are produced under increasing returns and that are highly income elastic in world markets, which means developing capacities in the production of manufactures.

A 'high road' industrial policy strategy requires private and public investment in infrastructure, education, basic and applied research and development, etc. aiming at "new environmentally sustainable, knowledge intensive, high skill and high wage economic activities. Specific activities that could be targeted include: a) the protection of the environment, sustainable transportation, energy efficiency and renewable energy sources; b) the production and dissemination of knowledge, applications of ICTs and web-based activities; c) health, welfare and caring activities" (Pianta 2014: 3). Several proposals to revive investment in the Euro area suggest improving energy efficiency and the role of renewable energies in particular. This would have a twofold positive effect. It would not only make industries more efficient and price competitive but also decrease the need for imports of energy resources and thus reduce the income elasticity of imports. Proposals like those of the Confederation of German Trade Unions (DGB 2012) or as expressed in OFCE/IMK/ECLM (2013) aim in this direction.

Given the very different structural composition and problems of the countries of the Euro area periphery, for each country in question regional and industrial policy strategies would have to be developed. These include the improvement of processes, for example increased automation, application of information technologies and changes in innovation culture in the existing companies and sectors. Also expansion into new business segments within the sectors can play an important role. In tourism, for example, higher segments such as business or luxury travel could be developed (Pawlicki/Stobbe 2012). However, Simonazzi/Ginzburg/Nocella (2013) argue that the southern periphery countries need to increase the diversification of their export structures. While upgrading into higher product categories in the already existing industries is an important part of this diversification process, it also includes entering new industries. As argued by Hausmann et al. (2013), the likelihood of sectors to become competitive and successful is higher for currently underdeveloped sectors with close proximity in necessary endowments to sectors already existing and strong in a particular country. Therefore, while it would be desirable for each of the countries in the periphery to enter the high-tech sector, positive results in the short to medium term are more likely in low-tech sectors. Consequently, the overall strategy should consider these constraints.

According to Thirlwall/Pacheco-López (2008, Chapter 5), for manufacturing sectors to develop, certain forms of protection, such as selective credits, subsidies to output as well as selective taxes on imports, may be necessary. Several of these instruments of trade protection are not available to EU and Euro area member countries. However, Hausmann/Rodrik (2002) argue that both trade protection and export subsidies are just second-best solutions since they cannot discriminate between successful innovators and unproductive imitators. Therefore, as a first-best policy, they argue for public sector credit and guarantees.[24] Here government development banks, such as the KFW in Germany, which closely cooperate with the commercial banking system, could be a good example, and are in line with the rules of the single market. Additionally, the European Investment Bank (EIB) could be used to support this process in the periphery countries. In 2013 the EIB had a capital of about 58 billion euro and a total balance sheet size of about 512 billion euro (EIB 2014a). This amounts to a total of about 4 percent of EU GDP. Besides providing funds, the EIB possesses financial and, more importantly, technical expertise and experience that it can provide to member countries (EIB 2014b). Furthermore, EU Structural Funds, which in the period 2007-2013 reached 347 billion euro (Pianta 2014), could be used to support infant industries in catching-up countries.

5.3 Stable long-term financing of current account deficits related to successful catching up

Third, despite lifting the BPCGR of the catching-up countries, successful catching up will most likely be associated with current account deficits in these countries. This is not a principal problem as long as growth is sustainably higher in the catching-up countries than in the mature current account surplus countries, and as long as the deficits are financed in ways that do not expose the respective countries to sudden stops or reversals of capital flows. Therefore, FDI or long-term loans should be preferred over short-term financial investments. The most obvious way to influence the types of capital flows into a country is the use of capital controls. However, their use is restricted under current EU regulations. As a substitute, banking regulation could incentivise banks to use more stable sources of finance. With the new liquidity regulation[25] (Detzer/Herr 2014, Chapter 15.6), the first step in this direction has already been taken in the EU. A financial transaction tax may also be helpful to discourage short-term financial investments and make long-term real investments more attractive while also generating financial resources for public investment (Schulmeister 2010).

If private capital flows to the current account deficit countries are not sufficiently stable, public funds could be used. Gros/Mayer (2013) propose creating a sovereign wealth fund for Germany. This fund would sell long-term bonds to German savers for retirement savings. The bonds would offer a guaranteed low and positive interest rate plus a bonus for any surplus achieved. According to the authors, the obtained funds should then be invested in Germany, directly, to modernise the German infrastructure. Additionally, the fund should provide other Euro area countries with long-term capital for private companies. And, on a global level, it could be invested in a diversified portfolio and so help to depreciate the euro exchange rate. This system could be extended to all

24 Private investment could also be channelled into the required areas by a system of asset-based reserve requirements favouring the desired types of investment (Palley 2004), window guidance as used by the Bank of Japan for a long time (Hoshi/Scharfstein/Singleton 1993) or through direct credit controls. Other incentives, like direct investment subsidies or tax breaks, could also be used.

25 The new liquidity regulation asks financial institutions to hold highly liquid assets as a buffer to cover sudden outflow of funds. It also intends to ensure a more suitable matching of maturities of asset and liability positions. Both measures can contribute to making banks more resilient to sudden liquidity withdrawals (by domestic as well as international lenders).

surplus countries so that a relatively large pool of patient capital is created which can be used to provide the necessary capital flows to the deficit countries.

Increasing and pooling a large part of public investment spending at the EU level with a focus on the catching-up countries would also decrease the need for private capital flows. Putting some investment responsibilities at the EU level is sensible, since many of the major future challenges can be tackled more easily if the solutions are jointly crafted at the EU level (e.g. climate change, development of EU-wide transport network, etc.). Here, an EU institution would raise its own funds (member country contributions, taxes and/or debt) and then provide the necessary capital flows to the countries in question by either directly investing in the relevant projects or by providing long-term loans to the investors.

A number of different proposals include such elements. For example, the proposal of the German Trade Union Confederation (DGB 2012) calls for a substantial investment package amounting to 2,600 billion euro over the next ten years and aiming at a European turnaround in energy policy, modernisation of infrastructure, improved education facilities, etc. To accomplish this, a European Future Fund is suggested, which should acquire an equity stake through a one-time wealth levy on high wealth individuals and receive the revenues of a newly introduced financial transaction tax. It then provides long-term loans or grants to private and public investors in the EU to facilitate the respective projects (DGB 2012). A similar idea to spur investment in Europe is brought forward by Varoufakis/Holland/Galbraith (2013), who propose setting up a European investment program using the EIB, the European Investment Fund (EIF)[26] and a newly founded venture capital fund. Since they want these institutions to act on a much larger scale than previously done, they argue that the ECB should keep the interest rate of the bonds issued by the EIB and the EIF at a low level by intervening in the secondary market if necessary. Also Bibow's (2013) proposal to pool investment spending with a new Euro Treasury could make sense in this context. While, as explained above, we do not see his suggestion as a proper solution for the fiscal policy requirements in the Euro area, the notion of pooling public investment at the Euro area level and funding them by issuing Euro Treasury bonds would be a good idea for mainly two reasons: on the one hand, individual countries would be sheltered from sudden capital flow reversals and, on the other hand, this would ensure that government budgets would not be consolidated at the expense of necessary investment spending.

6. Conclusions

In this paper we have outlined alternative policy recommendations addressing the problems of differential inflation, divergence in competitiveness and associated current account imbalances within the Euro area. We have argued that the major purpose of these alternative policy proposals should be to generate sustainably high demand and output growth in the Euro area as

26 The EIF was founded in 1994 and is part of the EIB group. It focuses on the provision of risk finance for small and medium-sized companies across Europe (EIF 2014).

a whole, providing high levels of non-inflationary employment as well as preventing ‘export-led mercantilist’ and ‘debt-led consumption boom’ types of development both within the Euro area and with respect to the role of the Euro area in the world economy. Making use of Thirlwall’s (1979; 2002) model of a BPCGR, we have provided a basic framework to systematically address the related issues. Based on this framework, we have outlined the required stance for alternative economic policies and have discussed the implications for alternative monetary, wage/incomes and fiscal policies in the Euro area as a whole, as well as the consequences for structural and regional policies particularly in the Euro area periphery.

We have argued that monetary policies of the ECB should refrain from fine-tuning output and inflation but should target low real interest rates, focus on financial stability and convincingly act as lender of last resort, both for the banking system and for the Euro area member country governments. For the latter, we have suggested that the ECB should target country-specific caps on government bond yields given by the long-run nominal GDP growth rate of the respective country. Wage policies should aim at stabilising income shares and contribute to stable inflation rates at the target rate for the Euro area as a whole. Wage policies should also contribute to re-balancing price competitiveness within the Euro area, but we would not expect large effects on the prevailing current account imbalances. Therefore, the major burden for internally rebalancing the Euro area as well as for stabilising aggregate demand at non-inflationary full employment levels falls on fiscal policies. We have suggested that functional finance fiscal policies should be applied and long-run government deficits/surpluses made use of to take up the excess of private saving over private investment at non-inflationary full employment output levels in each country, thus also preventing current account surpluses and deficits. To implement such a policy, we have proposed the coordination of expenditure paths for non-cyclical government spending of member countries as a strategy, accepting the present political preferences, which seem to exclude a United States of Europe with a federal government budget for the near future.

Finally, we have argued that perfectly balanced current accounts within the Euro area should not be expected as long as the periphery is catching up with respect to the centre. Successful catching up will be associated with current account deficits in the periphery and current account surpluses in the centre. These should be accepted and taken into account when coordinating fiscal policies, provided that the periphery grows at a sustainably higher rate than the centre. For this purpose, industrial restructuring and catching up should prevent unsustainable credit-driven bubbles and consumption booms, improve existing industries and develop new export industries to lift the BPCGR of the periphery countries. Furthermore, the prevailing and remaining current account deficits require stable capital inflows, for which we have provided several suggestions.

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Appendix A: Balance of payments constrained growth rate (BPCGR) in a currency union – without and with permanent and sustainable net capital inflows

Following Thirlwall (2002, chapter 5), we can derive the BPCGR in the following way. We start with a current account equilibrium:

(A1) $$p_d X = p_f eM,$$

where p_d is domestic prices, p_f is foreign prices in foreign currency, e is the exchange rate, X is exports, and M is imports. We are ignoring primary incomes coming from and going abroad, as well as income transfers. Equation (1) in growth rates gives:

(A2) $$\hat{p}_d + \hat{X} = \hat{p}_f + \hat{e} + \hat{M}.$$

Exports are determined in the following way:

(A3) $$X = Q\left(\frac{p_d}{p_f e}\right)^{\eta} Y_f^{\varepsilon}, \qquad \eta < 0, \varepsilon > 0,$$

with η denoting price elasticity of demand for exports, ε income elasticity of demand for exports, and Y_f foreign real income. From equation (A3) we get for the growth rate of exports:

(A4) $$\hat{X} = \eta\left(\hat{p}_d - \hat{p}_f - \hat{e}\right) + \varepsilon \hat{Y}_f$$

Imports are given as:

(A5) $$M = R\left(\frac{p_f e}{p_d}\right)^{\psi} Y_d^{\pi}, \qquad \psi < 0, \pi > 0,$$

with ψ denoting price elasticity of demand for imports, π income elasticity of demand for imports, and Y_d domestic real income. From equation (A5) we get for the growth rate of imports:

(A6) $$\hat{M} = \psi\left(\hat{p}_f + \hat{e} - \hat{p}_d\right) + \pi \hat{Y}_d.$$

Substituting equations (A6) and (A4) into equation (A2) yields the domestic rate of growth consistent with a current account equilibrium, the BPCGR:

(A7) $$\hat{Y}_d^b = \frac{(1 + \eta + \psi)\left(\hat{p}_d - \hat{p}_f - \hat{e}\right) + \varepsilon \hat{Y}_f}{\pi}.$$

Since in a currency union the nominal exchange rate among member countries is fixed – they all use the same currency – the BPCGR for the individual member country becomes:

(A8) $$\hat{Y}_d^b = \frac{(1 + \eta + \psi)\left(\hat{p}_d - \hat{p}_f\right) + \varepsilon \hat{Y}_f}{\pi}.$$

Including net capital inflows (C) measured in domestic currency to finance persistent current account deficits, equation (A1) becomes an identity:

(A9) $$p_d X + C = p_f eM.$$

Writing equation (A9) in growth rates

(A10) $$\left(\hat{p}_d + \hat{X}\right)\theta + \hat{C}(1-\theta) = \hat{p}_f + \hat{e} + \hat{M},$$

with θ as the share of export revenues in total receipts to pay for imports and (1-θ) as the share of net capital inflows. Using equations (A4) and (A6) again, the BPCGR from equation (A7) is modified to:

(A11) $$\hat{Y}_d^b = \frac{(1+\theta\eta+\psi)\left(\hat{p}_d - \hat{p}_f - \hat{e}\right) + \theta\varepsilon\hat{Y}_f + (1-\theta)\left(\hat{C} - \hat{p}_d\right)}{\pi},$$

and equation (A8) turns to:

(A12) $$\hat{Y}_d^b = \frac{(1+\theta\eta+\psi)\left(\hat{p}_d - \hat{p}_f\right) + \theta\varepsilon\hat{Y}_f + (1-\theta)\left(\hat{C} - \hat{p}_d\right)}{\pi}.$$

Net capital inflows lift the BPCGR if the growth rate of these inflows in real terms taking into account domestic inflation exceeds the growth rate of foreign GDP multiplied by the income elasticity of exports.

Appendix B: Current account imbalances and net foreign assets/liabilities

In a two country model net foreign liabilities of the domestic economy (L_d) are equal to net foreign assets of the foreign economy (A_f):

(B1) $$L_d = A_f.$$

Current account deficits (surpluses) mean a change in net foreign liabilities (assets) and hence:

(B2) $$\Delta L_d = \Delta A_f.$$

Dividing equation (B2) by equation (B1), it follows that the growth rate of net foreign liabilities of the domestic economy has to be equal to the growth rate of net foreign assets of the foreign economy:

(B3) $$\hat{L}_d = \frac{\Delta L_d}{L_d} = \hat{A}_f = \frac{\Delta A_f}{A_f}.$$

A constant net foreign liabilities-GDP ratio, or a constant net foreign-assets-GDP ratio, requires that net foreign liabilities, or net foreign assets, and nominal GDP ($p_d Y_d = Y_d^n; p_f Y_f = Y_f^n$) of the respective economy grow at the same rate:

(B4.a) $$\frac{L_d}{Y_d^n} \text{ constant, if } \hat{L}_d = \hat{Y}_d^n,$$

(B4.b) $$\frac{A_f}{Y_f^n} \text{ constant, if } \hat{A}_f = \hat{Y}_f^n.$$

Taking into account equation (B3), this means that the constancy of both the net foreign liabilities-GDP ratio of the domestic economy and the net foreign assets-GDP ratio of the foreign economy requires that the two economies have to grow at the same rate:

(B5) $$\frac{L_d}{Y_d^n} \text{ and } \frac{A_f}{Y_f^n} \text{ constant, if } \hat{L}_d = \hat{Y}_d^n = \hat{A}_f = \hat{Y}_f^n.$$

By definition, in a two country model net foreign liabilities have to grow at the same rate as net foreign assets. GDP growth rates of the domestic economy and the foreign economy, however, will not necessarily be equal. If this is the case, only one country can see a constant net foreign liabilities-/net foreign assets-GDP ratio, whereas the other will witness continuously falling or rising net foreign liabilities-/net foreign assets-GDP ratios. If we assume that the current account deficit country, the domestic economy, grows at a higher rate than the current account surplus country, the foreign economy, $\hat{Y}_d^n > \hat{Y}_f^n$, either a constant foreign liabilities-GDP ratio of the domestic economy will be accompanied by a rising foreign assets-GDP ratio of the foreign economy; or a constant foreign assets-GDP ratio of the foreign economy will be accompanied by a falling foreign liabilities-GDP ratio of the domestic economy. Of course, one may also obtain both a falling foreign liabilities-GDP ratio of the domestic economy and a rising foreign-assets-GDP ratio of the foreign economy. There may hence only be a tendency towards an ever rising foreign debt-GDP ratio of the domestic economy, if the current account deficit country, the domestic country, grows at a lower rate than the current account surplus country, the foreign country, $\hat{Y}_d^n < \hat{Y}_f^n$.

From equations (B3), and (B4.a) and (B4.b) we obtain that the long-run constant net foreign liabilities-GDP ratio for the domestic country and the net long-run constant net foreign assets-GDP ratio of the foreign economy are given as:

(B6.a) $$\hat{Y}_d^n = \hat{L}_d = \frac{\Delta L_d}{L_d} = \frac{\frac{\Delta L_d}{Y_d^n}}{\frac{L_d}{Y_d^n}} \quad \Rightarrow \quad \frac{L_d}{Y_d^n} = \frac{\frac{\Delta L_d}{Y_d^n}}{\hat{Y}_d^n},$$

(B6.b) $$\hat{Y}_f^n = \hat{A}_f = \frac{\Delta A_f}{A_f} = \frac{\frac{\Delta A_f}{Y_f^n}}{\frac{A_f}{Y_f^n}} \quad \Rightarrow \quad \frac{A_f}{Y_f^n} = \frac{\frac{\Delta A_f}{Y_f^n}}{\hat{Y}_f^n}.$$

With constant current account deficit-GDP ratios, or current account surplus-GDP ratios, and constant nominal GDP growth rates, the net foreign liabilities-GDP ratio, or the net foreign assets-GDP ratio, will each converge towards a definite value. As should be clear from the arguments put forward above, this can only hold for both economies simultaneously if their GDP growth rates are the same.

Let us assume next that the current account deficit (surplus) is composed of a trade deficit (surplus) and net interest payments (revenues) on the stock of net foreign liabilities (assets):

(B7) $$\Delta L_d = -NX_d + iL_d = \Delta A_f = NX_f + iA_f,$$

with $NX_d = p_d X_d - p_f e M_d$ as net exports of the domestic economy and $NX_f = p_f e X_f - p_d M_f$ as net exports of the foreign economy, i as the rate of interest on the stock of debt/assets, p_d as domestic price, p_f as foreign price and e as the exchange rate. Of course, in our two country model with the domestic economy as current account deficit economy we have: $-NX_d = NX_f$. Inserting equation (B7) into equations (B6.a) and (B6.b) yields:

(B8.a) $$\frac{L_d}{Y_d^n} = \frac{\frac{-NX_d + iL_d}{Y_d^n}}{\hat{Y}_d^n} = \frac{\frac{-NX_d}{Y_d^n}}{\hat{Y}_d^n - i},$$

(B8.b) $$\frac{A_f}{Y_f^n} = \frac{\frac{NX_f + iA_f}{Y_f^n}}{\hat{Y}_f^n} = \frac{\frac{NX_f}{Y_f^n}}{\hat{Y}_f^n - i}.$$

Therefore, provided that the rate of interest remains below the nominal rate of growth of the domestic economy, a constant trade deficit-GDP ratio to be financed by capital inflows will lead to a constant net foreign liabilities-GDP ratio. However, as soon as the rate of interest exceeds domestic nominal GDP growth, a positive net export-GDP ratio is required to stabilise the net foreign liabilities-GDP ratio.

Appendix C: Government deficit, government debt and nominal GDP

A constant government debt-GDP ratio (B/Y^n) requires that government debt (B) and nominal GDP (Y^n) grow at the same rate:

(C1) $$\hat{B} = \frac{\Delta B}{B} = \hat{Y}^n = \frac{\Delta Y^n}{Y^n}.$$

Since the government deficit (D) is given by:

(C2) $$D = G - T = \Delta B,$$

with G representing government expenditures and T government revenues (taxes etc.), equation (C1) becomes:

$$\text{(C3)} \qquad \hat{B} = \frac{\Delta B}{B} = \frac{D}{B} = \frac{\frac{D}{Y^n}}{\frac{B}{Y^n}} = \hat{Y}^n \qquad \Rightarrow \qquad \frac{B}{Y^n} = \frac{\frac{D}{Y^n}}{\hat{Y}^n}.$$

With a constant government deficit-GDP ratio and a constant nominal rate of growth of the economy, the government debt-GDP ratio will thus converge towards a definite value.

Let us now decompose the government deficit into a primary deficit (D') and the net interest payments on the stock of government debt (iB):

$$\text{(C4)} \qquad D = D' + iB.$$

Inserting this into equation (C3) yields:

$$\text{(C5)} \qquad \frac{B}{Y^n} = \frac{\frac{D' + iB}{Y^n}}{\hat{Y}^n} = \frac{\frac{D'}{Y^n} + i\frac{B}{Y^n}}{\hat{Y}^n}.$$

With a balanced primary budget, D' = 0 and hence D = iB, governments can thus service their debt by their current government deficits, hence without devoting tax revenues to debt services and hence without distributing income from the general public to the rentiers holding government debt, and stabilise the government debt-GDP ratio – provided that nominal GDP growth is positive. Rearranging equation (C5) gives:

$$\text{(C6)} \qquad \frac{B}{Y^n} = \frac{\frac{D'}{Y^n}}{\hat{Y}^n - i}.$$

If the growth rate of nominal GDP exceeds the nominal interest rate on government debt, governments can also run a primary deficit without compromising a long-run stable government debt-GDP ratio. However, if nominal GDP growth falls short of the nominal rate of interest, stabilising the government debt-GDP ratio will require a primary surplus in the government budget – and thus implies the use of tax revenues to satisfy the income demands of the rentiers holding government debt.

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On The Sustainability of the Euro

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Abstract

The August 2007 financial crisis and the subsequent 'great recession' have highlighted a range of problems with the 'euro project', which, we suggest, are related to some fundamental weaknesses of the euro. These problems and difficulties are discussed along with the reforms that have been introduced, especially so following the financial crisis and the 'great recession'. We begin by examining the theoretical underpinnings of the EMU model and the requirements for effective monetary union. We then turn our attention to the problems with the current EMU arrangements along with the nature of the reforms undertaken and their impact on the operations of the euro area. Required changes in economic policies are suggested with the general conclusion that such reforms are extremely urgent; especially so policies that would lead to political integration. Unfortunately they are not expected to be carried through. It is thereby concluded that the deep-seated problems are unlikely to be resolved, casting a dark shadow over the future sustainability of the euro.

1. Introduction

The European Central Bank (ECB), which administers monetary policy in the euro area, was established by the Treaty of Amsterdam in 1998. It launched the single currency (euro) in 1999 alongside with the foundation of the Economic and Monetary Union (EMU). The euro replaced the national currencies for all transactions at the beginning of 2002 for twelve countries, namely Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain. Since then another seven countries have joined the EMU and adopted the euro as their currency: Cyprus, Estonia, Latvia, Lithuania, Malta, Slovenia and Slovakia. Furthermore, there are the following that use the euro as their official currency but are not members of the EMU: Andorra, Kosovo, Monaco, Montenegro, San Marino and the Vatican City.[1] All in all 336 million Europeans use the euro as just shown.

The focus of this contribution is the sustainability of the euro under current arrangements. After this short introduction, we proceed to deal with the question just posed as follows. We begin our discussion with the theoretical underpinnings of the EMU model. We then deal with the requirements for an effective monetary union. Problems with the current EMU arrangements are then examined, followed by the required changes in economic policies. We, finally, summarize and conclude.

1 Andorra, Monaco, San Marino, and the Vatican City have formal agreements with the EMU to use the euro as their official currency and issue their own coins. Kosovo and Montenegro, have adopted the euro unilaterally, but they are not officially part of the EMU.

2. Theoretical Underpinnings of the EMU Model

We suggest that the EMU approach is of the New Consensus Macroeconomics (NCM) variety.[2] As such, its key elements are as follows: the market economy is viewed as essentially stable, and that macroeconomic policy (particularly discretionary fiscal policy) may well destabilise the market economy. Markets, and particularly the financial markets, make well-informed judgements on the sustainability of economic policies, especially so in the current environment of open, globalised, capital and financial markets. Monetary policy is a most flexible instrument for achieving medium-term stabilisation objectives and is the most direct determinant of inflation; in the long run the inflation rate is the only macroeconomic variable that monetary policy can affect. Fiscal policy is no longer viewed as a powerful macroeconomic instrument. Monetary policy has, thus, been upgraded and fiscal policy has been downgraded. Fiscal policy can only serve to achieve a balanced budget. In any case, fiscal policy is the task of national governments under a set of rules as in the Stability and Growth Pact (SGP) and the more recent change of it, what is now known as the Fiscal Compact.[3]

Monetary policy can be used to meet the objective of low rate of inflation. This is always a desirable objective in this view, since low, and stable, rates of inflation are conducive to healthy growth rates. However, monetary policy should not be operated by politicians, but by experts (whether bankers, economists or others). The ECB and the national central banks of the EMU countries comprise the European System of Central Banks (ESCB), and the ECB is endowed with the responsibility of the single monetary policy and with the additional characteristic of being ‘an independent central bank’, that is “independent from political influence” (ECB 2004: 12). The ESCB Treaty, Article 105 (1), states that “the primary objective of the ESCB shall be to maintain price stability” and that “without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2”. Such a bank would also have greater credibility in the financial markets and be seen to have a stronger commitment to low inflation than politicians would. Credibility is recognised as paramount in the conduct of monetary policy to avoid problems associated with time-inconsistency.

The EMU theoretical framework entails the view that inflation is best controlled through interest rate manipulation without at the same time forgetting money supply: there is, thus, the ‘close to 2% from below’ inflation target, and the reference value of 4.5% for M3 money supply in place. This, it is hoped, improves communication between the public and policy-makers and provides discipline, accountability, transparency and flexibility in monetary policy. The EMU model, then, differs from the strict inflation targeting approach. It contains a two-pillar approach, namely an economic analysis and a monetary analysis. The ECB economic analysis is an assessment of price developments and the risks to price stability over the short to medium term. The range of indicators includes: “developments in overall output; aggregate demand and its components; fiscal policy; capital and labor market conditions; a broad range of price and cost indicators;

2 See Arestis (2007) and Arestis and Sawyer (2008) for further details on the NCM theoretical framework.

3 For an extensive discussion of fiscal and monetary policy in the EMU, see Arestis and Sawyer (2006a, 2006b, 2006c).

developments in the exchange rate; the global economy and the balance of payments; financial markets; and the balance sheet positions of euro area sectors" (ECB 2004: 55-57). The ECB monetary approach analyzes monetary developments for the information they contain about future price developments over the medium and long term, exploiting the long-run link between money and prices. A 4.5% reference value for the M3 monetary growth is in place. Deviations from the reference value would 'signal risks to price stability'. Monetary analysis is utilized by the ECB as a 'cross check' for consistency between the short-term perspective of economic analysis with the more long-term perspective. The rationale of the 'two-pillar' approach is based on the theoretical premise that there are different time perspectives in the conduct of monetary policy that require a different focus in each case. There is the short to medium term focus on price movements that requires economic analysis. There is also the focus on long-term price trends that requires monetary analysis.

In this analysis, there is the strong belief by the ECB that there is a long-run stable relationship between money (M3) and inflation. This focus reflects the notion that inflation is a monetary phenomenon to be tackled by both manipulating the rate of interest and watching movements in M3. Short-term volatility of inflation is allowed but not in the long run, reflecting the view that monetary policy affects prices with a long lag (ECB 2004). The level of economic activity fluctuates around the Non Accelerating Inflation Rate of Unemployment (NAIRU), and unemployment below (above) the NAIRU would lead to higher (lower) rates of inflation. The NAIRU is a supply-side phenomenon closely related to the workings of the labour market. In the long run there is no trade-off between inflation and unemployment; the Phillips Curve is vertical at the NAIRU. So that the economy has to operate (on average) at the NAIRU, if accelerating inflation is to be avoided. In the long run, inflation is viewed as a monetary phenomenon in that the pace of inflation is aligned with the rate of interest and the money stock. The essence of Say's Law holds, namely that the level of effective demand does not play an independent role in the (long run) determination of the level of economic activity, and adjusts to underpin the supply-side determined level of economic activity (which itself corresponds to the NAIRU). Shocks to the level of demand can be met by variations in the rate of interest to ensure that inflation does not develop (if unemployment falls below the NAIRU).

3. Requirements for Effective Monetary Union

We have previously argued (Arestis and Sawyer 2006a, 2006b, 2006c, 2012) that in the absence of economic integration monetary unions without political integration would not, in general, have a good record of long-term survival.[4] Political integration then raises the issue of the requirements for such eventuality. We may summarise them as follows: EMU-level of expenditure programmes, taxation and a social security system. A common social security system that enhances labour mobility and involves elements of redistribution is of vital importance. Fiscal policy would

4 It is true, though, that those monetary unions involving very small countries, for example Eastern Caribbean Currency Union, which covers a total population of half a million, had a better survival rate.

likewise aid economic integration and would involve significant fiscal transfers between countries and regions, which is also of vital importance. The common currency of the EMU involves a degree of political agreement. The ECB is already the only macroeconomic policy maker; but EMU requires considerable central government to operate fiscal and social security policies across the euro area. Bordo et al. (2011) argue that this “interplay between several fiscal and one monetary authority” (Bordo et al. 2011: 7) in the EMU creates ‘free-riding issues’. How this works according to Bordo et al. (op. cit.) is as follows:

> “Each of the individual fiscal authorities sees itself only as a small player who has a little impact on the common monetary policy. As a result its fiscal policy choices would be purely driven by national interests. In equilibrium, each country free-rides and the outcome is worse than the one that could be reached in a cooperative equilibrium” (Bordo et al. 2011: 7).

It is also relevant to add at this stage the importance of a central bank with the function of the lender of last resort; this is lacking at the moment in terms of the ECB.[5]

The history of monetary unions is very informative on the issues discussed above. Bordo et al. (2011) suggest that the financial crisis of 2007-2009, which resulted in severe debt crises in a number of the EMU countries in 2010 and 2011, provide very good examples where the absence of a pan-EMU fiscal mechanism is serious in this respect. The political and fiscal history of five federal states, namely Argentina, Brazil, Canada, Germany and United States are used to make the case. This leads Bordo et al. (op. cit.) to suggest a number of relevant conditions as follows: “The first and probably the most important condition is a credible commitment to a no-bailout rule. The second one is a degree of revenue and expenditure independence of the members of the fiscal union reflecting their preferences. The third condition is a well developed transfer mechanism to be used in episodes of distress. This transfer mechanism can be facilitated by the establishment of a common bond. The fourth condition is a capacity to learn from past mistakes and adapt to new economic and political circumstances” (Bordo et al. 2011: 26-27). The euro area, therefore, needs an effective fiscal union.

Sylla (2014) discusses the ‘Early US Struggles with Fiscal Federalism’ for any ‘Lessons for Europe’ to conclude that despite the very different experiences between the early US and the recent European experience, it is the case that the latter “nonetheless bears similarities to the United States under the Articles of Confederation during the 1780s, when the interests and rights of member states trumped measures designed to foster a stronger union” (Sylla 2014: 174). It is then the case that Europe can learn from the US experience. Sylla (op. cit.) summarises the lessons as follows: “One is that a weak central government is not the best way to form a more perfect union of states. That more perfect union probably requires taxing powers at the union

5 It is permissive but not mandatory for the ECB to act as a lender of last resort. The general practice is for a central bank to act as a ‘lender of last resort’ and to operate such that ‘sound financial paper’ is discounted at the pre-announced discount rate and exchanged for base money. Banks can then obtain reserves from the central bank in exchange for ‘sound financial paper’. The Treaty of Lisbon and its forerunners, bar the monetisation of member governments’ deficits and debts.

level, not merely quotas and requisitions from member states. A second is that assumptions of the sovereign debts of member states by the union can solve many problems and help to create a union-wide capital market. A third is that it helps to have at the union level strong leadership that is capable of executing well-formulated plans" (Sylla 2014: 173). Eichngreen et al. (2013) reach similar conclusions in that "In principle, there is scope for not just monetary union but also for banking, fiscal and political union, opening up avenues for resolving the crisis not available in other regions. That said, there remain obstacles to a concerted, Eurozone-wide response to the crisis in practice. Increasingly one worries that it is the obligations and not the opportunities that dominate" (Sylla 2014: 2).

4. Problems with Current EMU Arrangements

We begin by stating the conditions for 'Optimal Currency Area' (OCA); these are: factor mobility and openness of markets; relative price flexibility across countries and thus similar inflationary tendencies amongst them; fiscal transfers within the monetary union. It is clear that OCA considerations played little role in the formation of the euro area and since then they do not seem to have been met (Arestis and Sawyer 2012). The euro area then does not appear to be an OCA (see also, Baldwin and Wyplosz 2009). But there are further problems with the current EMU arrangements.

In terms of monetary policy, changes in interest rates have only a limited impact on aggregate demand. We have surveyed elsewhere the results of simulations of the effects of monetary policy using macroeconometric models, including that of the ECB (Arestis and Sawyer 2004; Angeriz and Arestis 2009). The conclusion of these studies is that the effects of interest rate changes on inflation tend to be rather small – typically a 1 percentage point change in interest rates may dampen inflation by 0.2% to 0.3% after two years; and there is significant impact of changes in the rate of interest on real variables in the medium to long run. In terms of the impact of interest rates on expenditure, there are questions relating to the magnitude of the impact, timing and variability of the time lags involved. It is also the case that since interest rate policy has a range of effects, such as on aggregate demand, on the exchange rate, distributional effects etc., the objective of monetary policy should reflect those effects; and should thereby include growth and high levels of employment alongside inflation. The two-pillar approach of the ECB is, therefore, problematic.

In terms of fiscal policy it is dictated by the 'Stability and Growth Pact' (SGP). The core elements of SGP are three: to pursue the medium-term objectives of budgetary positions close to balance or in surplus; the submission of annual stability and convergence programmes by the member states; and the monitoring of the implementation of the stability and convergence programmes. Even if it is accepted that the budget should be balanced over the cycle, there is little reason to think that the extent of the swings in the budget position will be similar across countries. What reason is there to think that a swing in the deficit to a maximum of 3% of GDP is relevant for all countries? Countries will differ in the extent to which their GDP varies in the course of a business cycle and in the extent to which the budget position is sensitive to the business cycle.

Changes in economic policies have taken place following the August 2007 financial crisis, the subsequent 'great recession' and the euro crisis. We turn our attention to these changes next with a focus on the recent ones.

The European Leaders agreed in principle at their meeting in Brussels on the 8th/9th of December 2011 to adopt tougher sanctions on the euro area countries that break the 'new' rules of the 'fiscal pact', what is now called the 'fiscal compact' (FC). This is an inter-government treaty, not a change to the EU treaties. Its main ingredients are three: a firm commitment to 'balanced budgets' for the euro area countries, defined as a structural deficit of no greater than 0.5% of gross domestic product, which should be written into the national constitutions; automatic sanctions for any euro area country whose deficit exceeds 3% of GDP; and a requirement to submit their national budgets to the European Commission, which will have the power to request that they be revised. In effect the FC retains the principles of the previous 'fiscal pact' versions but with the added one that countries that break the deficit rules may actually be punished in some way. The limits of the revised and old SGP are in effect to balance the overall budget over the cycle and limit the national budget deficit in any year to a maximum of 3% of GDP. In place of the previous threat of 0.2% of GDP as a 'fine' (though never implemented even though there were 40 cases where the 3% limit was breached), there is now a change, which is as follows: euro area states' budgets should be balanced or in surplus; this principle will be deemed respected if, as a rule, the annual structural deficit does not exceed 0.5% of gross domestic product; and this is to be written into national constitutions. In the case when a euro area member state is in breach of the 3% deficit ceiling, the old SGP ceiling, there will be automatic consequences, including possible sanctions, unless a qualified majority of the euro area states opposes it. It is also the case that the rule of the old SGP of 60% debt to GDP ratio is retained. Any excess should be eliminated at an average rate of a 20th of the excess each year. For example, a country with debt at 80% of GDP would be required to reduce this ratio at 1% of GDP each year. Unlike previous treaties, the 'fiscal compact' only needed to be ratified by 12 out of the then 18 euro area members. Only countries that have ratified the 'fiscal compact' could get loans from the newly established European Stability Mechanism (ESM).[6]

Clearly the 'fiscal compact' treaty reflects the notion that the euro crisis was due to fiscal indiscipline; consequently more discipline is the only solution. Such principle is clearly misleading. The FC, like the old SGP, seeks to impose without any justification a balanced budget and poses restrictions in the use of fiscal policy in the face of economic crises. Even more, the 'fiscal compact' requires countries to in effect run surpluses. In all these, though, there is no central power with sufficient discretionary means to organize some sort of fiscal transfer. Indeed, not only does the fiscal compact not provide a concrete answer to this question, but it does not even hint

6 The ESM is the permanent crisis resolution mechanism for the countries of the EMU. The ESM issues debt instruments in order to finance loans and other forms of financial assistance to EMU countries. The decision to create the ESM was taken by the European Council in December 2010. The ESM was signed on the 2nd of February 2012, and inaugurated on the 8th of October 2012.

whether fiscal transfers are likely to happen or not. It is the case that proper fiscal union is the only way forward. The ‘fiscal compact’ was signed on the 1st of March 2012 by all EU members, with the exception of the UK and the Czech Republic. The treaty has been ratified by individual parliaments and, in the case of Ireland, by a referendum, which confirmed it. It is now renamed as the Treaty on Stability, Coordination and Governance, and the treaty entered into force on the 1st of January 2013.

The EMU summit meeting, on the 28th/29th of June 2012, took a number of decisions: banking licence for the European Stability Mechanism (ESM) that would give it access to the ECB funding and thus greatly increase its firepower; banking supervision by the ECB; a ‘growth pact’, which would involve issuing project bonds to finance infrastructure. Two long-term solutions were proposed: one was a move towards a banking union[7] and a single euro area bank deposit guarantee scheme; another was the introduction of Eurobonds and euro bills. Germany resisted the latter, arguing that it would only contemplate such action only under a full-blown fiscal union. More developments emerged then. The President of the ECB promised in July 2012 to do ‘whatever it takes’ to save the euro, which was confirmed after the ECB’s first meeting of 2014 (Thursday 9th of January). The ECB introduced in September 2012 the ‘Outright Monetary Transaction’ (OMT) bond-buying tool only in secondary markets. In June 2014 the ECB introduced new steps to counter deflation: reduced its benchmark interest rate from 0.25% to 0.15% (further reduced to 0.05% in September 2014); introduced a negative deposit rate, whereby the ECB would be charging commercial banks 0.1% (changed to 0.20% in September 2014) on their deposits with it. In September 2014, the ‘Targeted Long-Term Refinancing Operation’ (TLTRO) was introduced. Banks can borrow up to 7% of their loans to companies and individuals (exclusive of mortgages) in two tranches in September and December 2014. Banks can borrow for up to four years so long as they use the funds to lend to households and companies. This means that banks would be able to borrow roughly 400 billion euros, cumulatively over four months. The ECB announced that it would study the possibility of security purchases. But, no ‘forward guidance’ was introduced as in the case of the Fed and the Bank of England.

Germany’s Central Bank, the Bundesbank, has never warmed to the OMT. The matter was referred to the German constitutional court, which decided that the OMT programme was not covered by the mandate of the ECB; it, therefore, violated the German constitution. The court considered OMT as ‘monetary financing’, whereby the Central Bank would print money to finance sovereign debt; it was, thus, not legal under European treaties. The German constitutional court concluded that only the European Court of Justice (ECJ), the highest legal court in the EU, could decide on the matter; it was, therefore, referred to the ECJ on the 7th of February 2014. On the 14th of January 2015, the ECJ released an Advocate General opinion on the legality of the ECB’s OMT. The ECJ found OMT in line with EU law, with a final ruling to be issued in the months to follow.

7 An interesting question is whether a banking union is a sufficient solution to the euro area’s systemic weaknesses (Pisari-Ferry 2011: 152). Clearly this could not be such a condition without a pan-EMU fiscal policy.

The ECB at its meeting on the 22nd of January 2015 decided to undertake Quantitative Easing (QE). Under the QE scheme, the ECB would purchase €60 billion of euro zone bonds and other safe financial assets, every month between March (2015) and September (2016), or until inflation is back to the ECB's inflation target. This implies total purchases worth roughly €1.1 trillion, equal to around 10% of the EMU's GDP. The ECB QE was confirmed by its President after the governing council's meeting on the 5th of March; QE was launched on the 9th of March 2015. Whether the ECB QE would work is questionable (Oakley, 2015). EMU banks, insurance groups and pension funds may need the relevant assets, which the ECB needs to buy, to meet their relevant capital requirements (Solvency II).

It is worth noting that another problem had emerged prior to the QE announcement. This problem was related to objections to the proposed banking union. Five German academics filed a case whereby they claimed that banking union was illegal and contrary to the German constitution because it was created without the necessary treaty changes. This case could take months winding its way through court hearings but will force officials from the European Commission and the ECB to defend the banking union. The banking union is thereby set to face a challenge in Germany's constitutional court.[8]

Another problem relates to the exchange rate. It may be that the poor performance of some of the EMU countries since its formation can be attributed to an inappropriate exchange rate. The euro has become the second major currency in the world after the dollar, and the exchange rate between euro and dollar has become particularly important for a large proportion of international trade. The volatility of the euro:dollar exchange rate becomes significant not only for the euro area and the USA, but also for those countries that have linked their currency to either the euro or the dollar. These problems strongly point towards the development of mechanisms, which could help to stabilise the euro exchange rate.

We now proceed to suggest a range of macroeconomic policies and reforms, which would substantially improve the economic performance and sustainability of the Economic and Monetary Union. But we should not underestimate the political, legal and ideological barriers, which are raised against policy changes along the lines indicated. But it is clear that the EMU cannot proceed with its current policy arrangements, and for those who strive for economic integration in the EMU must realise that changes are urgently required 'to save the euro'.

5. Required Changes in Economic Policies

We discuss the required changes in the EMU economic policies in view of the discussion above and the problems identified therein in what follows in this section. We begin with monetary policy.

8 In any case the banking union proposal was modified in that a compromise was struck whereby a two-tier system emerged: the ECB would have responsibility for the supervision as well direct responsibility for overseeing the larger financial institutions. The national sovereigns would have the responsibility for resolving ailing financial institutions (Pisari-Ferry 2011: 150).

5.1 Monetary Policy

Reformulation of the objectives of the ECB to include high and sustainable levels of employment and economic growth, in addition to price stability (and indeed these objectives should also be firmly embedded in the European Constitution). The two-pillar strategy should be abandoned to avoid the serious problems discussed above, which can easily lead to loss of credibility, especially when the two pillars provide contradictory signals. The ECB must be made accountable to the European Parliament and should proceed to regular publication of the minutes of its rate-setting governing council.[9] The ECB statutes should be changed so that it can clearly be involved in the co-ordination of fiscal and monetary policies. Ultimately ECB should be ready to take instructions from other European bodies, such as the ECOFIN.[10] The ECB should undertake explicitly the role of lender of last resort, and should be made responsible for the stability of the EMU financial system. In this respect, the ECB should be responsible for all deposit insurance. A Banking Union would be a good start on this issue (Goodhart 2013).

5.2 Fiscal Policy

Coordination of fiscal policy across member countries is paramount. Budget deficits should be used in pursuit of economic objectives such as high levels of employment. This approach views fiscal policy as one of the instruments of economic policy, which can be used to achieve specific economic objectives. A budget deficit or surplus (or indeed balance) is not then sought to meet some predetermined figure but rather it should be used in conjunction with other policies to maintain high levels of demand in the economy. This would imply the need for an EMU budget, which is not constrained to be balanced as at present and which can be utilised for EMU-wide stabilisation purposes. Ultimately the development of an EMU fiscal policy should be introduced. This would require a large increase in the scale of the EMU budget and the ability of the EMU to operate a budget deficit, or indeed a budget surplus. This would imply the need for an EMU budget, which is not constrained to be balanced as at present and which can be utilised for EMU-wide stabilisation purposes.[11]

5.3 Co-ordination of Economic Policies

Full co-ordination of the major policies is important (Arestis 2012, 2015). Monetary and fiscal policies both affect the level of aggregate demand, exchange rate and perhaps the rate of inflation, which point towards coordination between monetary and fiscal policies, without forgetting financial stability. Indeed, when fiscal policy is coordinated with monetary policy, it is

9 The ECB minutes of the January 2015 governing council meeting were published for the first time in the history of the ECB on the 19th of February 2015. These minutes relate to the discussion of the ECB governing council on the 1.1tr euros QE programme. Even so, and unlike the Bank of England and other central banks, the ECB minutes do not reveal how the individual members of the council voted. Still, publishing minutes with proper account of the discussions and of voting needs to be implemented.

10 The ECOFIN is composed of the ministers of Economics and Finance, as well as Budget Ministers when budgetary issues are discussed, of the member states of the European Union.

11 Feldstein (2015) argues for a “strategy of revenue neutral fiscal incentives”, which though might not be “politically feasible and, if pursued, might still not reignite growth in the Eurozone”. Under such circumstances “there may be no way to end the euro crisis while preserving the euro” (Feldstein 2015: 7).

more effective as the recent empirical evidence, as reviewed in Arestis (2015), suggests. As it is also argued in Arestis (op. cit.), the 'great recession' has highlighted the importance of financial stability, which had been ignored prior to it, mainly because of the firm belief and emphasis on the 'efficient market hypothesis' (EMH). However, the events leading to the 'great recession' testify to the important requirement of financial stability. The focus of financial stability should be on proper control of the financial sector so that it becomes socially and economically useful to the economy as a whole and to the productive economy in particular. Banks should serve the needs of their customers rather than provide short-term gains for shareholders and huge profits for themselves. Proposals that aim to ensure financial stability have been put forward and we have discussed these proposals in Arestis and Karakitsos (2013). As a result financial stability has attracted renewed interest and focus as an instrument of monetary policy. We would argue that full co-ordination of both monetary and financial stability policies with fiscal policy is powerful in terms of the impact of fiscal policy on economic activity. We would go one step further and suggest that discretion is as important in applying such co-ordination (Arestis 2012, 2015).

It should be noted also that the 'independence' of the ECB would appear to preclude co-operation and co-ordination between the different bodies responsible for aspects of macroeconomic policies.[12] Yet, in a world of multiple objectives (including high levels of economic activity and employment, financial stability, inflation etc.) there is a need for multiple instruments, which are operated by different authorities, and where there should be some co-ordination. At present, it is more like subordination with monetary policy taking pride of place and fiscal policy neutered by the lack of EMU fiscal policy and the constraints of the SGP on national budget deficits.

5.4 Further Required Changes

There should be changes in the objectives of the ECB to include that of the external value of the currency, and interest rates would have to be set with regard to their effects on the exchange value of the euro. The target exchange rate would be set by the Council of Ministers of the Eurogroup, and the ECB would be required to support that policy (through its interest rate policy and through interventions in the foreign exchange markets). The objectives of the ECB would have to be changed to include that of support of the external value of the currency. Interest rates would have to be set with regard to their effects on the exchange value of the euro. It is very important for the EMU to formulate an official exchange rate policy and abide by it. The achievement of full employment without inflationary pressures should be the ultimate objective. This does require an appropriate high level of aggregate demand, and the creation of sufficient capacity to support full employment. The enhancement of the functions of the European Investment Bank (EIB), or a similar institution, to ensure high rates of capital formation, across the EMU becomes relevant. The achievement of high levels of economic activity without inflationary pressures requires two additional elements: first, institutional arrangements for collective wage determination and price setting, which are conducive to low inflation. Wage determination within the EMU is currently undertaken on a decentralised and fragmented basis. Second, the present

12 See, also, Sawyer (2010) on the issue and problems of independent central banks.

disparities in regional unemployment levels (and also in labour market participation rates) within the EMU would suggest that even if full employment were achieved in some regions, there would still be substantial levels of unemployment in many others. There is, thus, a need for regional economic policies; a revamped EIB would be very important on this score.

Widening inequalities in the euro area should also be tackled (see, for example, OECD, 2008). Not merely within euro members, but also inequalities and social conditions among member states have been drastically aggravated by recent austerity policies (European Commission 2013: 463-464). It is clear then that economic policies to tackle inequalities in the euro area should be forthcoming.

It is also important to note that current account imbalances among the EMU member countries were not considered in the process of setting up the euro area (see Arestis and Sawyer 2008, for further details). However, more recently and in view of the 'great recession' a new mechanism for the prevention and correction of macroeconomic imbalances has been proposed (European Council 2010). Economies with problematic imbalances would be identified along with numerical monitoring. Subsequent inspections would be undertaken to identify the seriousness of the problem and recommendations would be proposed. The latter could include corrective measures to be reviewed by the Council subsequently. Even so, though, the pattern of current account imbalances poses considerable difficulties for EMU.

The major challenge now facing EMU is how to correct the pattern of surpluses and deficits, and to put in place policies, which will prevent similar severe imbalances reappearing in the future. This requires the EMU to abandon the current policy approach based on a country-by-country perspective, and concentrate instead on the interdependence of the member states of the euro area. The alternative would require a long-term plan to improve competitiveness and build an industrial base. This, however, is a long-term solution and it is short-term solutions that are desperately required. In other words, policies to enable the flow of funds from surplus to deficit countries, during the period of reconstruction, are required. It is the case, then, that eventually political integration to sort out this particular problem is also inevitable. In the meantime, and in the absence of such mechanism and in view of perfectly balanced current accounts in the euro area cannot be expected to materialise, alternatives are paramount. This is especially so when periphery countries attempt to catch up with the more prosperous countries of the centre. Under such circumstances successful balancing throughout the euro area cannot be expected so long as the periphery is in this process. This implies that in the interim to political integration "Successful catching up will be associated with current account deficits in the periphery and current account surpluses in the center" (Hein and Detzer 2014: 32).

6. Summary and Conclusions

We have discussed the theoretical underpinnings of the EMU model and have assessed current economic policies in the EMU. Changes have been suggested. The proposals put forward are essentially euro-area-wide economic policies with proper co-ordination of them. What in effect amounts to political integration.

We would argue that the policy framework within which the euro is placed is 'not fit for purpose'. Three aspects of this argument stand out. First, the 'independence' of the ECB precludes the ECB devoting its attention to financial stability and to co-ordinating and co-operating with other macroeconomic institutions in pursuit of other objectives, such as high levels of economic activity. Second, it does not have ways of developing fiscal policy, which would be supportive of high levels of economic activity, recognising that budget deficits are generally required. Third, there are no mechanisms for resolving the pattern of current account deficits and surpluses.

Indeed, the history of monetary unions around the world is very telling. In the absence of economic integration, a monetary union without a political integration simply cannot survive (Arestis and Sawyer 2006a, 2006b, 2006c, 2012). Whether the latter or any other fundamental change is forthcoming, it is unfortunately a very sad expectation. It should also be clear that cosmetic measures as currently proposed will not save the euro. It is undoubtedly the case that the euro experiment is going through a severe test. This is a great pity for as Pisany-Ferry (2011) suggests "most of the architects of the euro expected monetary unification to be a stepping-stone towards political integration" (Pisany-Ferry 2011: 166).

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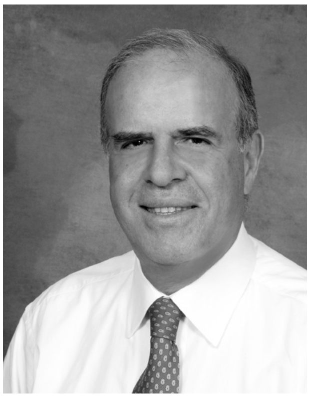
Thanos Skouras

Europe's failing: not excessive sovereign debt but complacent leadership



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Abstract

The euro crisis is not due to excessive sovereign debt. It is rather due to the European leadership that is loath to recognize the euro's flawed architecture and take the steps towards a federal European state, which are needed to complete its unfinished construction. It is particularly Germany's self-seeking stance, in preserving an institutional setup that serves her well despite its dangers for European unity, which constitutes the main obstacle to overcoming the crisis.

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Introduction

Europe is entering its fifth year of weak growth and high unemployment. The economic weakness breeds social discontent and political extremism which destroy faith in a united Europe and undermine the European project. The crisis in which Europe and particularly the Eurozone are enmeshed, contrary to a widespread belief, is not due to excessive sovereign debt. It is rather due to the European leadership that is loath to recognize the euro's flawed architecture and take the steps in the direction of a federal European state, which are needed to complete its unfinished construction. It is particularly Germany's self-seeking stance, in preserving an institutional setup that serves her well despite its dangers for European unity, which constitutes the main obstacle to overcoming the crisis.

The present paper develops this thesis by posing and answering ten relevant questions. The questions that serve to develop the argument are the following: 1) What is the European sovereign debt? 2) Is there a debt crisis? 3) Why is there talk (without evidence) of a debt crisis? 4) What is the cause of the increase in debt? 5) What are the obstacles to repairing Europe's failing? 6) Why is Germany complacent? 7) Does the concept of 'competitiveness' make sense? 8) What is the distinction between 'essential' and ''effective' competitiveness? 9) How does membership of the Eurozone help Germany's competitiveness? 10) How does Germany's complacency affect Europe?

1. What is the European sovereign debt?

The sovereign debt has reached 92.7% of GDP for the Eurozone and 87% for the EU28 in 2014.[1] The rise in the debt-to-GDP ratio began in 2007, after being seemingly stabilized and hovering at about 60% for the previous ten years. To put this into perspective, the U.S. ratio is about 100% and the Japanese is over 240%, both having risen considerably after 2007.[2]

A comparison with the debt levels reached in the aftermath of the Second World War may also provide some perspective. In 1946, debt reached 121.3% of GDP in the U.S., 135.9% in Canada, 90.4% in Australia, and 237.1% in the U.K. (rising further to 237.9% in 1947).[3] These very high debt ratios were gradually lowered largely through inflation and GDP growth. It may be noted that neither in the late 1940s nor in the U.S. and Japan recently, was public discussion fixated on a debt crisis and, in both cases, the main concern has been about achieving growth.

A further perspective may be obtained by contemplating the condition in which new, especially young, home-owners find themselves in many countries. The amounts they have borrowed exceed their annual income by many times, yet they normally manage to service and eventually repay their debt without considering themselves to suffer from a debt crisis.

In view of this evidence, it is not at all clear that the European sovereign debt, which is still rising though at a much slower pace, is excessive and that Europe is suffering from a debt crisis.

2. Is there a debt crisis?

A debt crisis arises when the debt-to-GDP ratio cannot be reduced by the economy's growth (i.e., by the ratio's denominator increasing faster than the numerator).[4] Then, a reduction in the ratio necessitates hard choices and certainly a reduction in the debt's rate of increase if not an outright reduction in its absolute level.

The question is whether Europe's debt has reached or is close enough to the point of Europe being in a debt crisis. A reason for considering that this is indeed the case is provided by the work of C.M. Reinhart and K.S. Rogoff. (see Reinhart/Rogoff 2009, also 2010). Their influential book, which is notable for the large international database on debt that they have compiled, reaches a striking conclusion: Growth practically ceases when the debt/GDP ratio exceeds 90% or

1 http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=teina225&plugin=1

2 http://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx

3 http://reinhartandrogoff.com/data

4 The absolute level of debt is of little importance; the debt relative to income is what matters. Debt relative to population is also unimportant, despite common references in the popular press to high figures of debt per head. The irrelevance of the latter becomes obvious in the case of debt being domestically held. Then, debt per head is exactly equal to the value of bonds or assets per head. It is, of course, true that, in honoring the debt, the state collects (unequally) from more or less the whole population to pay the creditors who own the bonds (and constitute usually only a small part of the population).

thereabouts. On the basis of this, Europe can be seen to suffer from a debt crisis and its stalling growth rate is easily explained as being due to its excessive debt.

There are, nevertheless, serious problems with Reinhart and Rogoff's statistical analysis which invalidate their conclusion.[5] Apart from technical weaknesses, there is doubt whether any clear correlation can be established between growth and debt. Reinhart and Rogoff have accepted some mistakes and repudiated the strict 90% debt/GDP watershed at which growth supposedly ceases but claim that, in general, growth tends to slow down as debt rises.

Nevertheless, even this claim is doubtful as a causal relation. A negative correlation between growth rates and debt/GDP does not establish the direction of causation, which may go either way. Theoretically, high debt may cause growth to falter by raising interest rates and lowering investment. But it is also possible that faltering growth may cause debt to rise, by reducing tax revenues and increasing government expenditure on unemployment benefits (thus leading to budget deficits).

In conclusion, there is no reliable basis for claiming that rising debt dampens growth and, of course, there is no basis at all for maintaining that Europe is in a debt crisis. On the contrary, there is reason to believe that in a depressed economy, expansionary fiscal policy necessitating greater government debt is beneficial in restarting growth and possibly in reducing the debt/GDP ratio.[6]

3. Why is there talk (without evidence) of a debt crisis?

The belief in a European debt crisis may have little basis in reality but it is decidedly useful in making the policy of austerity acceptable. Austerity is the policy of restraining and curtailing the government budget, aiming at achieving a balanced budget (or even one in surplus) by reducing public expenditure and increasing taxes. It must be remembered that a policy of near-austerity, prohibiting budget deficits exceeding 3% of GDP and aiming at a balanced budget over time, has been enshrined (largely at the insistence of Germany) in the Maastricht Treaty and the constitution of the euro.

The policy of austerity or a balanced budget, when elevated to a principle, makes little economic sense. The government budget is not like the budget of a private individual or firm but should be

5 The first alert was signaled by a paper from Herndon/Ash/Pollin (2013 and 2014): "Does High Public Debt Consistently Stifle Economic Growth? A Critique of Reinhart and Rogoff". This replicated Reinhart and Rogoff's statistical analysis and uncovered data omissions, questionable weighting methods, as well as basic coding errors. Moreover, "differences in average GDP growth in the (debt) categories 30-60%, 60-90% and 90-120% cannot be statistically distinguished".

6 This is the basic Keynes' lesson and it has been upheld time and again since the 1930s; for a recent reconfirmation see, for example, the article by Bradford Delong/Summers (2012).

viewed as a social instrument for controlling the magnitudes of aggregate demand and employment or, more generally, the level of economic activity.[7]

Nevertheless, it has to be recognized that 'austerity' is a concept that holds sway over the public imagination, which is not used to differentiate the validity of a principle according to whether it relates to the whole or to the parts of a social entity.[8] Consequently, the potential of 'austerity' for political exploitation is not to be underestimated, and this is presently in full evidence. Today, it constitutes the dominant policy across Europe and is championed primarily by Germany but also by other, northern European countries which are influenced by Germany. It is accepted by the rest of the EU, which happen to be on the whole more indebted (and southern) because it is generally believed that it is the only appropriate response to the debt crisis. Belief in the debt crisis is, therefore, essential to the acceptance of the austerity policy.

It may, of course, be asked: Why does Germany champion austerity? This question will be answered in section 6 below. Suffice it to say here that it allows Germany to continue being in a particularly advantageous position (albeit by imposing a heavy burden on the indebted countries) rather than squarely face Europe's failing and assume the cost of repairing its flawed constitution. First, however, the nature of the European failing needs to be explained in some detail, starting with the cause of the increasing debt.

4. What is the cause of the increase in debt?

The increase in debt was caused by the preceding banking crisis, to which it is inextricably linked. This requires some elaboration.

The rapid rise in public debt, not only in Europe but also in the U.S., is due to the global financial crisis that began with the bursting of the bubble that had developed in the American subprime mortgage loans market in August 2007. The crisis became global in October 2008 with the bankruptcy of Lehman Brothers, a major global bank, which followed in close succession the bankruptcy of the internationally active Icelandic banks. These events, and particularly Lehman's rather unexpected collapse, caused a huge shock to the banking world, leading to an all-round loss of confidence and a freezing of the global financial system.

In these circumstances and in order to avoid a total financial catastrophe, it became imperative for the American and European governments to guarantee that no other financial institution of systemic importance would be allowed to fail. Both sides fortunately understood the grave

7 This fundamental tenet of 'functional finance' was clearly and convincingly explained more than 70 years ago (see Lerner 1943; also Forstater 1999).

8 This common logical mistake is known as the 'fallacy of composition' and, in economics, it leads to misguided attempts to eliminate macroeconomic theory by subsuming it under microeconomics. For a critique, see Kitromilides/Skouras (2014); also, on the ideological and institutional roots of this mistake in economics, see Skouras/Kitromilides (2014).

threat to the world economy and, in effect, the European finance ministers made the necessary pledge to intervene to the extent required in November 2008, thus avoiding widespread panic and calming the financial markets.

Mrs. Merkel made it absolutely clear that the guarantee to save a country’s systemic banks, agreed by the finance ministers’ meeting in November 2008, was the sole responsibility of each individual state, and that there was no question of the European Union or the Eurozone acting collectively as a whole.

Mrs. Merkel’s declaration ensured that the markets’ attention would be concentrated on whether each individual country’s public finances could support its own banking system.[9] After this, it was inevitable that eventually the countries with the weakest banks needing the greatest public support, as well as those with the least healthy public finances, would see the risk premium they had to pay shoot up and would find it increasingly difficult to borrow. Saving a country’s banking system implies, in these circumstances, rapidly increasing public debt and possibly government insolvency.

It is clear that the pledge to save the banking system meant that there would be, as required, a substitution of public for private debt. The state, which is financially stronger, more trustworthy and less liable to go bankrupt than the banks, would save them from bankruptcy by guaranteeing their debt obligations and fortifying them with the provision of additional capital. The recapitalization of the banks was crucial for the restoration of their economic health and the public’s all important confidence.

The Americans began immediately (even before Lehman’s collapse) to recapitalize their systemic banks by running budget deficits and increasing public debt. The Europeans, on the whole, did not. The main reason was that they were subject to the constraints imposed by the Maastricht Treaty. They were not supposed to run deficits exceeding 3% of GDP and, in addition, they were not allowed to borrow from the European Central Bank (ECB).

Consequently, their ability to raise funds was circumscribed by their credit rating and the financial markets’ assessment of their credit worthiness. Until then, this assessment was based until then on the assumption that governments in the Eurozone would be able to turn to the ECB in case of emergency and, therefore, the risk of defaulting on their debt obligations (at least those in euros) was practically non-existent. But this assumption was declared by Mrs. Merkel to be unfounded.

In conclusion, the public debt crisis was caused by the banking crisis, which was itself aggravated by the fundamentally flawed constitution (or architecture, as it has come to be known) of the European Monetary System. There is little doubt that the Maastricht Treaty rules hindered rather than helped the provision of a proper response to the banking crisis. If further evidence

9 This declaration’s significance in heralding, if not practically inviting, the euro crisis has been underlined by George Soros, who noted “This sowed the seeds of the euro crisis because it revealed and activated a hidden weakness in the construction of the euro: the lack of a common treasury” (Soros 2011).

were needed, it is available in the much better way Britain handled the potentially far more severe banking crisis in the case of Britain. Not subject to the Maastricht constraints, the British government could recapitalize its highly exposed and vulnerable banking system relying on the backstop assured by its central bank.

The lesson to be drawn is that the Eurozone's imperfect architecture needs to be completed in two crucial ways: First, with the creation of a common European Treasury and, second, with an enlargement of the ECB's warrant, enabling it to act unfettered as a lender of last resort for both financial institutions and the European Treasury.[10]

5. What are the obstacles to repairing Europe's failing?

There are two types of major obstacles (undoubtedly intertwined and interdependent) to the completion of the Eurozone's architecture and the advancement of European integration. The first pertains to the realm of ideas and the proper understanding of what is required, and the second has to do with the sphere of economic and political interests.

As regards the understanding of the present European ailment, which is the first obstacle, it has already been argued that the emphasis on public debt rather than on banking frailty is mistaken. The belief that the basic problem requiring urgent attention and appropriate institutional reform is the containment of public debt, though prevalent, is quite misguided. Its wide acceptance is due to two factors.

The first was the mindset behind the design of the Maastricht rules, which considered that the risk to the euro could only come from irresponsible and unbridled public spending. The rules were all aimed at protecting the Eurozone from such an eventuality.

The second is due to a historical accident, which was crucial in creating a strong, though false, impression about the causes of the European crisis. This was the fact that Greece was the first country in trouble, which signaled to the international public opinion the onset of the crisis. Greece was the exceptional country that met the expectations of the Maastricht Treaty, since it was the only one where the weakness of public finances was greater than that of its banking sector.

There was nothing inevitable about Greece being the *first* country to default; it was the contingent calling of early Greek national elections in October 2009, as a result of boundless political strife, combined with the exposure of the inexcusable falsification of national statistics for political

10 The start that was made in the creation of a Banking Union, with the regulation of the systemic banks by the ECB (which needs to be completed without delay, especially with a Europe-wide common deposit guarantee), as well as the extensive QE program of the ECB, though important steps in the right direction, still fall short of what is required in fully unfettering the central bank.

advantage and the post-election disclosure of an excessively high budget deficit[11] that caused Greece's insolvency before any other country. If Ireland had defaulted first, as seemed quite possible at the time, irresponsible public spending could not have been blamed and the nature of the crisis would have been clearly revealed.[12]

The second obstacle to necessary reform is the more difficult to overcome. Germany, which from the start has been indisputably the frontrunner of European integration and is today the only country that can lead in the construction of a united Europe, is quite comfortable with the present situation and is against any reform that may involve cost for her. Even reforms, like the banking union, which Germany has accepted in principle, are delayed by Germany in practice. Similarly, Germany tends to find problems with initiatives by the ECB to arrest the tendency to disinflation and accepts them only half-heartedly in the end.

Unfortunately, the fact seems to be that following the effort for her re-unification, Germany does not any more seem interested in leading towards a federal Europe or even in furthering European integration, unless it serves her national interests. Gone are the days that Germany could declare that she had no national foreign policy, only a European one. Today, Germany seems to be concerned with pursuing above all her own interests, with Europe being only a means to this end.

6. Why is Germany complacent?

Despite the claims of eurosceptics and the belief of large segments of her public opinion, Germany has gained considerably from the existence of and membership in the euro. It is this gain that happens to be abetted by the present problems of Europe which accounts for its complacency. Any of the steps that are required to get Europe out of the present rut would necessitate an abandonment of the particularly comfortable position enjoyed by Germany today and also an inevitable reduction in her gains.

Germany's gains are perversely served and further magnified by the Eurozone's difficulties. The euro crisis emanating from the global financial crisis, benefits Germany by augmenting her productive potential and economic strength while correspondingly further weakening the already weaker economies, which are suffering most from the crisis. This wayward effect (which is contrary to any notion of solidarity), is produced in at least two ways. First, there is a considerable benefit from the inward movement of savings and capital out of the risky sovereign bonds and shaky banks of the indebted southern countries. This reduces Germany's cost of borrowing, which is already the lowest in the Eurozone, even further while raising the borrowing cost not only for the government but also the private sector of the weaker economies. Second, Germany's

11 It was more than twice as high as originally reported, reaching 12.5% of GDP, and was later (end of 2010) confirmed at 15.6%.

12 Ireland, which defaulted six months later than Greece in November 2009, was a model of fiscal rectitude before the global financial crisis and Irish sovereign debt did not exceed 25% of GDP in 2007 (being considerably lower than that of France and Germany).

economy benefits greatly from the immigration of skilled and educated young labor force from the indebted countries, where youth unemployment has reached unprecedented high levels. This is of great importance in sustaining high productivity and productive potential, as Germany is an aging country with an extremely low rate of population growth.

It should be noted that the perverse effects of the crisis mentioned above reinforce Germany's competitiveness, and further weaken the low competitiveness of the indebted countries. It is this differential in competitiveness which has enabled Germany to reap the greatest benefit from the euro. The common currency has made it easier for Germany, the competitiveness of which is superior to that of most other countries in the Eurozone (and particularly to that of the South), to increase its exports to them. This is the effect that has attracted most public attention, since it is immediately noticeable in Germany's increased market share in their home markets. This is, however, not the main cause of their own loss of home market share nor is it the most important part of Germany's gain from the euro. After all, most of Germany's exports are not to the Eurozone but to the rest of the world. It is in relation to the rest of the world that the euro has given Germany a great advantage and has correspondingly disadvantaged the southern countries.

The fundamental reason for Germany's gain is to be found in the euro's exchange rate. The euro's exchange rate has allowed Germany to have a stronger export performance than would have been possible if Germany had still a national currency such as the mark. At the same time, the euro's exchange rate has made the less competitive southern countries even less competitive in their trading with the rest of the world.

The way that the euro's exchange rate has in effect leveraged Germany's inherent or essential competitiveness will be examined in section 9 below.

Before such an examination, it is important to meet a possible objection to the concern with and use of the notion of competitiveness.

7. Does the concept of 'competitiveness' make sense?

Despite the widespread use of the notion of competitiveness in public policy discussion and the regular compilation of an international competitiveness index, there is a certain reluctance among academic economists in accepting the coherence and legitimacy of the concept.[13]

The reason is that it makes an odd fit with the economic theory of international trade. There is no question that it has a mercantilist provenance and, from Adam Smith onward, economics has consistently rejected mercantilism as a norm of economic policy.

13 For example, Paul Krugman has argued that "… competitiveness is a meaningless word when applied to national economies. And the obsession with competitiveness is both wrong and dangerous" (Krugman 1994, also 1996).

There is no question that trade is generally beneficial for all parties concerned, even though the benefit may be unequally shared. In fact, a trade deficit confers a greater immediate tangible benefit than a trade surplus, since the former raises the standard of living and/or investment potential of a country while the latter lowers it. In contrast, the surplus provides claims on future production of uncertain real value. It would seem then that the deficit is clearly preferable. Things change in a setting of unemployment and spare capacity, however. In these circumstances, the surplus also increases profits and, through higher profit, encourages production and employment. On the other hand, the deficit reduces profits and tends to lead to lower production and employment.

Consequently, in a world of monetary production for profit, often characterized by unemployed resources, a trade surplus makes a lot of sense. This, admittedly, may be a second-best policy but in the real world the first-best policy may, for various reasons, not be feasible. It is in such a context that competitiveness, understood as the ability to consistently achieve surpluses, becomes a useful policy aim.

Competitiveness is a notion borrowed from microeconomics and competition among firms that becomes rather complex and hazy when applied to a country. For this reason, a distinction is made below between 'essential' and 'effective' competitiveness.

8. What is the difference between 'essential' and 'effective' competitiveness?

To begin with, 'essential' competitiveness is, analogous to its usage in microeconomics, where it denotes firms' relative ability to compete, and refers mainly to sales cost (including production, finance and marketing costs) but also to other elements, such as product characteristics (including quality, reputation and image), distribution networks, accessibility to markets and any other factor that contributes to a firm's ability to achieve sustained profitability and do consistently better than its rivals.

In the case of a country, in addition to the above, it includes institutional elements, such as the quality and performance of the education system, the legal system, labor relations and the functioning of the labor market, market structure and the degree of monopoly, as well as any other institution that contributes to the country's better economic performance relative to other countries sharing the same currency (or having a long-standing stable exchange rate).

It is evident that 'essential' competitiveness may be affected by changes in any of the above elements. Consequently, it may also be affected by changes in monetary and fiscal policy (as well as other policies and conditions, such as a minimum wage or incomes policy or even prospects regarding political developments), which can have an effect on the level of prices and in the financing conditions and borrowing rates, (in the latter case, either directly or through changing perceptions of country risk).

‘Essential’ competitiveness can be compared and contrasted to a related but somewhat different notion, that of ‘effective’ competitiveness. ‘Effective’ competitiveness refers to the ability of a country to compete in international markets with countries that do not share its currency, which depends crucially not only on its ‘essential’ competitiveness but also on the exchange rate.

‘Effective’ competitiveness generally moves in the opposite direction to a change in ‘essential’ competitiveness, when countries do not share the same currency. This is because a change in ‘essential’ competitiveness tends to be compensated by a change in the exchange rate. Thus, for example, an increase in a country’s ‘essential’ competitiveness tends to increase the exchange rate of its currency, which makes its exports more expensive and its imports cheaper. The result is a reduction in exports and an increase in imports, which is tantamount to a fall in its ‘effective’ competitiveness.

In trading within a currency union, the member countries’ ‘essential’ competitiveness is all important in determining the intra-union trade balances. But since members also trade with countries outside the currency union, their ‘effective’ competitiveness is also important in determining their trade balance vis-a-vis their trading partners outside the currency union. How does an increase in ‘essential’ competitiveness affect ‘effective’ competitiveness within a currency union? Within the union, a member country’s increase in ‘essential’ competitiveness increases its intra-union export share. It also increases its ‘effective’ competitiveness and export share in its trading with countries outside the union. This is because the exchange rate of the currency union is determined by the ‘essential’ competitiveness of all its members, in trading as a bloc with the rest of the world.

It may be concluded that, unless the particular country’s trade is large enough to weigh heavily on the currency union’s exchange rate, the exchange rate is hardly affected and the country’s increase in ‘essential’ competitiveness is accompanied by an increase in its ‘effective’ competitiveness. In other words, the compensatory change in the exchange rate, which causes the ‘effective’ competitiveness to move contrary to any change in ‘essential’ competitiveness, is practically absent when a country is a member of a currency union. This is more likely to be the case, the smaller the country share of the union’s external trade and the greater the differences in the ‘essential’ competitiveness of the currency union’s members.

9. How does membership of the Eurozone help Germany’s competitiveness?

Given that the Eurozone’s current account is roughly in balance (or exhibiting a small surplus), the euro’s exchange rate tends to roughly reflect the Eurozone’s overall competitiveness relative to the rest of the world. The euro’s exchange rate has resulted in large surpluses for Germany and, to a lesser extent, some Northern European countries, and equivalent deficits for mostly Southern European countries. Consequently, the exchange rate has augmented the effective competitiveness of Germany and the North, which had higher essential competitiveness than the

South, and weakened the latter's effective competitiveness. In other words, the euro's exchange rate was too low for balance in the current account of Germany and the North, while being too high for balance in the current account of the South.

More generally, it may be stated that membership in the currency union tends to reinforce the effective competitiveness of a country that has higher essential competitiveness than the union average, and to lessen the effective competitiveness of a country that has lower essential competitiveness than the union average. Put differently, membership enables those countries which are more essentially competitive than the average to have an exchange rate that is lower than would have been the case if they were not members, thus leveraging their effective competitiveness vis-a-vis the rest of the world. Conversely, membership obliges countries with below the union average essential competitiveness to have a higher exchange rate than what would be the case outside the union, thus further reducing their effective competitiveness vis-a-vis the rest of the world.[14]

Moreover, a currency union with a balanced foreign account shields its members from correction by market forces and allows surpluses (by the most competitive countries) and deficits (by the least competitive countries) to develop and be sustained without hindrance. Such imbalances may in fact continue practically indefinitely, so long as the associated capital flows are not blocked and allowed to go on.

This effect becomes evident if we imagine Germany outside the Eurozone. Then, Germany's exchange rate against the US dollar would tend to be higher and, as a consequence, she would be effectively less competitive. More importantly, unlike what has been the case whilst she was a member of the Eurozone, she would find that a surplus in its foreign account is not sustainable. If she attempted to manipulate the exchange rate and fix it at a lower level, she would provoke protest and retaliation from its trading partners. Conversely, if Greece or Portugal were outside the Eurozone, their exchange rate against the US dollar could not fail to be lower than it is today in the Eurozone, thus rendering them effectively more competitive. Market forces would ensure in this instance that their exchange rate is corrected so that their foreign account deficit is eliminated.

10. How does Germany's complacency affect Europe?

In conclusion, it has to be recognized that the euro buttresses and further reinforces Germany's essential competitiveness and, for this reason, Germany has an interest in preserving it. Unlike

14 An analogy from the world of competitive sports may be helpful here. The handicap system used in diverse sports, such as golf or horse races, is analogous to the movements in the exchange rate following a change in relative essential competitiveness. For example, according to horses' relative performance in training and in previous races, they are saddled with different weights, so as to equalize the chances across all horses competing in a race. In this setting, a currency union is like grouping the horses of a stable together and assigning a single common handicap to all of them, on the basis of their average performance. Such an arrangement, would obviously grant the best performing horses of the stable an unfair advantage and, by the same token, disadvantage the worst performing ones when competing with other horses, which have been given a handicap based on their individual performance.

in the period before the reunification, however, Germany seems to be distancing herself from assuming the responsibility of European leadership, signaling that she is contented with the present European course and is prepared to pay for the preservation of the euro only the minimum possible price. Germany's complacent stance is that there is no serious flaw in the euro construction, other than the poor implementation of the Maastricht rules. What is needed for Europe as a whole is strict adherence to fiscal discipline and structural reforms. The belief is that, in this way, all countries can improve their competitiveness (both essential and effective) and become like Germany. This, even if feasible, which is doubtful, certainly requires considerable time and is not a serious policy option for the pressing needs of the less competitive countries.

The fact is that the euro crisis, emanating from the global financial crisis, has left the less essentially competitive countries in a weak state and heavy debt, from which they are unlikely to recover soon without bold reforms of the European architecture. Without a banking union making the ECB a true lender of last resort, without a common treasury or some scheme to enable sovereign borrowing at a low cost comparable to Germany, and without a European investment program in infrastructure sufficiently large to jumpstart growth, they are condemned to stagnation at best. Reduction of public debt tends to lead to fiscal strangling of the private sector and discourages growth. The burden of debt can only be reduced (in proportion to GDP) if there is growth but without such reforms, growth is unlikely, if not impossible.

The prospect of continued protracted stagnation is politically very dangerous. It breeds the politics of populism, xenophobia and extremism, which have already strengthened euroscepticism and are bound to threaten not only the survival of the euro but even the cause of a united Europe. This is a critical time for Europe and urgently calls for broad-minded and benevolent leadership, which can effectively be provided only by Germany.

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Ana Podvršič

From a Success Story to the EU Periphery: Spatialisation Strategies of Capitalist Accumulation in Slovenia's Post-Yugoslav Development

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Abstract

Continual economic growth, political stability and a neo-corporatist system are some of the factors mentioned most frequently when one talks about Slovenia's post-socialist transition. For a long time considered a success story, the most prosperous and stable of the European post-socialist countries and the first among the new EU member states (2004) to enter the European Monetary Union (EMU) (2007), Slovenia was badly hit by the post-2008 socio-economic crisis. In local right-wing discourses, a gradual transformation approach with concomitant deceleration of the "structural" reforms as well as corrupted or greedy political and economic elites supposedly are the main reasons for the difficulties the Slovene economy is still facing. On the other side, leftist discourses among other aspects mostly focus on the "neoliberal" turn of Janša's government in the mid-2000s contributing to the indebtedness of the Slovene economy. Contrary to these views, we argue that it is necessary to situate the development of Slovene capitalism within the broader process of the "making of the EU post-socialist periphery". The article proposes to combine three analytical perspectives: a labour-centred approach to capitalist development, critical theory of international relations, and dependency school. Two mechanisms of the hierarchical structuration of national economies within the EU are identified, via international flows of industrial capital and via international flows of financial capital. Then, the Slovene spatialisation strategies are analysed. For analytical reasons three periods are distinguished: the making of Slovene capitalism (1985-1992), the securing of Slovene capitalism (1992-2004) and the disarticulation of Slovene capitalism (2004-2008). The conclusion provides insight into how the crisis further reveals the European peripherisation of the capitalist economy of Slovenia.

> Men make their own history, but they do not make it as they please; they do not make it under self-selected circumstances, but under circumstances existing already, given and transmitted from the past.
>
> Karl Marx, The Eighteenth Brumaire of Louis Bonaparte

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1. Introduction

Continual economic growth, political stability and a neo-corporatist system are some of the factors mentioned most frequently when one talks about Slovenia's post-socialist transition. For a long time considered a success story, the most prosperous and stable of the European post-socialist countries and the first among the new EU member states (2004) to enter the European Monetary Union (EMU) (2007), Slovenia was badly hit by the post-2008 socio-economic crisis. A gradual transformation approach with concomitant deceleration of the "structural" reforms as well as corrupted or greedy political and economic elites supposedly are the main reasons for the difficulties the Slovene economy is still facing. Contrary to this widely held view, we argue that it is necessary to situate the development of Slovene capitalism within the broader process of the "making of the EU post-socialist periphery". Deriving from a more or less sophisticated Varieties of Capitalism framework, the dominant (institutionalist) literature acknowledges capitalism only "as a more pronounced set of 'external constraints' on various actors and institutions [and] not as mode of production that needs to be critically analyzed" (Bruff 2015: 116). Therefore, the article first elaborates on an alternative framework building on the labour-centred Marxist perspective on (international) capitalist development, followed by an account of the development of the Slovene political economy. After analysing the spatialisation accumulation strategies of the Slovene state from the mid-1980s until 2008, we conclude by providing insight into how the crisis further reveals the peripherisation of the Slovene capitalist economy within the EU space of accumulation.

2. Theoretical background

The alternative theoretical framework starts from the assumption that capitalism represents a historically established social mode of production characterised by systemic pressure to produce surplus value, i.e. to raise the level of exploitation resulting from social actors depending on the market for their survival. It combines three analytical perspectives: a labour-centred approach to capitalist development, critical theory of international relations, and dependency school.

According to Selwyn (2014), the particular development of a national capitalist economy is determined by the conflicts over the appropriation and redistribution of the surplus value between labour, capital and capitalist state. The latter is of particular importance as it has autonomous capacities to overcome the particular interests of local factions of capital and to act on behalf of the system as a whole. States engage in building institutions designed not only to structure the behaviour of their citizens and to simultaneously reproduce state power, but also to guarantee the process of capital accumulation. Their autonomy is only relative as it is ultimately limited by their dependence on the success of capital accumulation. Therefore, various state institutions must be understood as outcomes of prior and on-going struggles between social, economic and political actors.

Since its emergence, capitalist production has been a global phenomenon in as much as its expansion has depended on access to cheaper human, material and financial inputs not available on local or national markets. As Lacher (2006) outlines, the fact that international accumulation of capital is legally fragmented by territorialised spaces of nation states has important consequences for the nature of capitalist competition. As competition in the world market is (1) mediated by state boundaries, states (2) organize the external projection of national class interests through foreign policy, diplomacy and military force. As capitalist states mostly compete with each other in geopolitical struggles for various resources on the world markets and their potential profits, they pursue different "spatialisation strategies" (Lacher 2006: 121) to structure, or at least influence, the world economy and the international division of labour. One of the main effects of changing spatialisation strategies of states (and also of social classes and companies) and the subsequent "territorial capital configuration" (Lacher 2006: 112) is the hierarchical structuration of the world economy.

However, the form of the international hierarchical structure manifests itself in a historically determined way depending on how a specific international conjuncture influences the outcomes of local struggles.[1] One of the possible historical outcomes of competitive spatialisation attempts by a particular set of states is the establishment of a core-periphery pattern (Lacher 2006). Different authors of dependency school emphasize that there are asymmetries between the economic processes of the core and the periphery, the second being subordinated to the first in several economic and political aspects. "[T]he distinction between 'central' and 'peripheral' economies [...] incorporates immediately the idea of unequal positions and functions within the same structure of overall production" (Cardoso/Faletto 1979: 18). Contrary to Frank's (1966) mechanist view of dependency relations, Cardoso and Faletto's historical structural approach (1979) does not regard dependence simply as an external variable. Although the limits for manoeuvring are largely set by the world system, the particular internal configuration of a country determines the specific response to the same external events. To contrast Frank's "development of under-development" thesis and to emphasize that the forms of dependence are not permanent and that some of them are compatible with local industrialisation, Cardoso (1972) introduces the concept of "dependent capitalist development". More importantly, Cardoso and Faletto (1979) stress that only a specific historical study could give us an account of the mechanisms and institutional "embeddedness" of centre-periphery relations between a particular set of national economies.

3. From Yugoslav core socialist economy to EU peripheral capitalism

This brief outline of the historical development of capitalism in post-socialist formal Slovene territory of capitalist accumulation will necessarily reduce the complexity of the historical process. First, mechanisms of the hierarchical structuration of national economies within the EU are dis-

1 This formulation aims to emphasize the necessity to overcome national/international and global dichotomy and suggests applying a dialectic understanding of nationalisation and globalisation. As Milios and Sotiropoulos (2009: 197) outline, "[t]he [international conjuncture] is incorporated – and exerts its influence – as a secondary contradiction (in the sense that it does not have priority over class struggle) within the social formations[.]"

cussed. Then, the Slovene spatialisation strategies are analysed.[2] For analytical reasons three periods are distinguished: the making of Slovene capitalism (1985-1992), the securing of Slovene capitalism (1992-2004), and the disarticulation of Slovene capitalism (2004-2008).

3.1. Mechanisms of the hierarchical structuration of national economies within the EU

Contrary to the common idea that European integration represents a pacific project that would unite and guarantee prosperity to European nations, it is rather a class project aiming to secure and reinforce capitalist accumulation in the European space (Cocks 1980; Bonefeld 2002; Panitch/Gindin 2012; Durand 2013). The main effect of the successive waves of institutional re-regulation accompanying the EU's geographical expansion is the establishment of a supranational institutional architecture that enables the centre-periphery divide between the old and new members (Becker/Jäger 2012). Regarding relations between the post-socialist EU member states from Central and Eastern Europe (CEE) and the leading economies of the EU, Durand[3] identifies two economic channels of the hierarchical structuration of national economies within the EU, i.e. via international flows of industrial capital (foreign direct investments, FDI) and of financial capital.

One of the major concerns of the neoliberal design of post-socialist transition, promoted by the policies of the USA and the EU, and of the EU's enlargement strategy was to integrate the post-socialists spaces of capital accumulation into the expanding production networks dominated by the central EU states and to open post-socialist economies to FDI. Although these policies, coupled with the outcome of local struggles, contributed to the "manufacturing miracles" (Bohle/Greskovitz 2012: 161) in CEE and strengthened the regulatory capacities of local states, the CEE economies re-integrated internationally in a dependent mode. This resulted in significant economic and political dependence of the CEE economies on investment decisions by multinational corporations (Holman 2004; Bohle 2009; Nölke/Vliegenthart 2009; Drahokoupil 2009).

The recent crisis of the EMU has revealed another dimension of core-periphery relations within the EU, i.e. the international flows of financial capital. The institutional configuration of the EMU preventing currency devaluation has reinforced inequalities between the member states, contributing to a specific pattern of interaction between national economies and supporting a neo-mercantilist accumulation strategy in Germany (Bellofiore et al. 2010). Its current account surpluses have been translated into capital exports – not only FDI as already mentioned, but also bank lending – to peripheral countries. Weaker EMU economies have thus increasingly compensated for its uncompetitive position with reliance on cheap credits that have flooded the euro market (Lapavitsas et al. 2012). Through so-called informal euroisation (Becker/Jäger 2012) this unequal EMU dynamics has also affected a number of European states that have not yet adopted the euro. The common characteristic of these financial flows, singular to the EU socio-economic dynamics, is that generally they have not improved the local productive basis but rather fuelled the consumption and real estate booms (Becker 2013).

2 For an account of the recent development of German political economy from the perspective of the changing territorial constitution of (German) capital, see Bruff, 2015.

3 Personal correspondence, 02/09/2014.

These two mechanisms seem to reproduce two distinctive rationales. Although the specific intertwining of these social logics was particular to each CEE economy, they were part and parcel of the process of peripherisation of post-socialist states. On one hand, industrial FDI that contributed to a significant economic restructuring of the CEE reproduces the rationale of "dependent capitalist development". On the other hand, the "non-productive" financial flows within the EU seem to rather follow the rationale of centre-periphery relations captured by Frank (1966), the logic of the so-called "development of underdevelopment" (cf. Krašovec 2013a).

Considering international patterns of accumulation of the post-socialist CEE economies, Slovenia had a specific role: similar to others, it based its economic growth in the 90s on export-led industrialisation combined with increasing indebtedness in the previous decade (Becker 2013). However, unlike in other countries, FDI played a minor role in the development of Slovene capitalism. Until the post-2008 crisis privatisation program, its trajectory was characterised by a strong opposition to EU pressures regarding privatisation and by the reluctance of local political and social actors to sell national enterprises to foreign investors (Lindstrom/Piroska 2007). To explain this particular pattern, it is necessary to consider the spatial constitution of Slovene capital, the contradictions it entails and the social struggles regarding the social organisation of capitalist accumulation.

3.2. The making of Slovene capitalism (1985-1992)

The Slovene socialist economy (SSE) was the core economy in socialist Yugoslavia. After a short period of post-war shortages of skilled labour, the SSE was able to achieve full employment and sustain it for forty years, with unemployment never exceeding 1.5 percent until 1985. However, the (inherited) skilled labour force, the industrial infrastructure and a favourable geographic position near western markets would not have contributed that much to rapid Slovene industrialisation without a development strategy put in place by the Yugoslav Communist Party leaders (Woodward 1995). Foreign trade regulation was one of the most important policies biased towards the development of the SSE. It significantly facilitated and encouraged the SSE to access foreign currency, technological know-how and equipment in several ways: first, as Yugoslav leaders favoured industrial goods exports to international rather than federalist markets, there were no barriers to foreign exports. Second, those who obtained foreign currency were required to divide their earnings among the suppliers of the goods at all production levels. As Slovene industrial production was highly vertically integrated, foreign currency could largely be retained within the republic. Third, the inflow of foreign currency allowed the purchase from abroad of higher-quality inputs than comparably priced domestic equivalents. Thus, the SSE simultaneously came to be the principal exporter of technology to international markets and the principal recipient of the inflow of different kinds of foreign capital. However, particularly in the 1980s, this trade pattern was increasingly premised on a double dependence of the SSE on foreign markets: the markets secured local firms' competitiveness by giving them access to (cheaper) raw materials; at the same time, on average Slovene enterprises sold roughly one-third of their production to foreign markets (Bookman 1990).

The particular form of SSE international integration was probably one of the important reasons for the turning point in the accumulation strategy of the Slovene political and economic elites after 1985, hiding behind the discourse of the "Yugoslav exploitation of Slovene workers" and "the return to Europe". In the middle of the Yugoslav debt crisis, geo-political developments between the old EU members suggested new opportunities for foreign capital, Western trade, and eventually integration into the EU. "The resumption of commercial-bank lending to Eastern Europe gave profitable exporters a way to get around federal restrictions on foreign exchange; foreign investment began to flow into Slovenia and Croatia; and both Italy and Austria expanded economic ties eastward, including the opening of affiliates of four Austrian banks in Ljubljana" (Woodward 1995: 357). More importantly, the institutional reforms towards centralisation demanded by international creditors and by a macroeconomic stabilisation policy directly endangered the Slovene economic and political elites' property rights to economic resources earned by producers on the republic's territory and consequently the material basis of their political legitimation based on securing the living standard of Slovene workers. Strengthening federal administration and delegating monetary policy to the independent central bank would prevent republican economies from retaining foreign currency, while domestic price liberalisation diminished the advantages to the SSE of federal price regulations that until then had favoured Slovene industrialisation (Woodward 1995).

To understand how these events contributed to the emergence of Slovene capitalism, which would be embedded in neo-corporatist institutions and assure the leading roles of the state and the post-Yugoslav managers, it is necessary to consider the Yugoslav socio-political dynamics during the 1980s. The federal regulations of production with their continual reformist zigzags actually reinforced the republics' authority as the implementation of austerity measures depended on republican administration and the decisions of local politicians. Moreover, since the 1960s, decentralisation and the ascension of the younger management anchored on the republican level had further reinforced the tendency of the elites to understand the hardships of the crisis from the perspective of their republics and provinces. This is significant as Yugoslav self-management actually strengthened their management and control over workers, especially during periods of crisis, when directors were allowed to circumvent the established decision-making system and to act on their own (Centrih 2014). That does not mean, however, that Yugoslav labour was "weak". It had exceptional formal power and throughout the 1980s workers' actions were in fact increasing (Stanojević 2003). In most cases, however, they stayed limited to classical forms of industrial conflict and focalised on the enterprise level. A logic of individual competition and status as well as the regulation of labour markets on the republican level further fuelled workers' individualism and encouraged the rise of a strong, yet "nationalised" and fragmented Yugoslav labour movement (Woodward 1995; Musić 2011; Centrih 2014)

Regarding the Slovene development, these socio-political dynamics contributed to a unique unity of party leadership, enterprises and population on the necessity to separate from the Yugoslav self-managed economy and the federal League of Communists (Woodward 1995). If private property and the so-called "market economy" started to be considered as the "natural environment" for Slovene production (cf. Centrih 2014), the concrete institutional embeddedness of the emerging capitalism depended on the local socio-political struggles between influential management, reform-oriented and publicly supported political elite, and a strong labour under the leadership of newly established (1987) independent unions. The latter, however, now functioned as "suitable partner[s] in 'social dialogue' or mere pressure group[s] during the transition to capitalism" (Centrih 2014: 6).

Albeit at the turn of the 1990s the Slovene economy with its relatively low external debt and budget deficit was comparatively in a better position than its counterparts (Stanojević 2014), the loss of the Yugoslav and COMECON markets together with the economic recession in the West hurt local production more than expected (Mencinger 2004). While the local factions of dominant political and economic strata disputed different techniques of the management and appropriation of the Yugoslav socialist assets, Slovene workers had to face a relatively new phenomenon concerning their social status and living standards, i.e. unemployment, peaking at 9% in 1993. When in 1992 – the year when the economic crisis bottomed out – the then governing coalition announced a wage freeze, the unions organised a general strike which practically stopped formal national production for several hours. 1992 indeed was a decisive year for the Slovene capitalist path: the popular unrests influenced the institutional architecture of Slovene political economy (Stanojević 2003). As will be shown now, it also impacted the spatial accumulation strategies that the Slovene political and economic elites had to pursue if they were to assure the reproduction of Slovene capitalism.

3.3. Securing Slovene capitalism (1992-2004)

The strike wave at the outset of the transition influenced the capitalist development in Slovenia during its moving closer to the EU in several ways. It helped remove a right-wing coalition from power, resulting in a twelve-year centre-left hegemony. It also shifted the appropriation-of-socialist-assets debate towards so-called "distributional" privatisation, which was one of the anchors of Slovene neo-corporatism. The state and different state funds became majority owners of the large, capital-intensive companies. While managers first acquired important shares in all companies, in the process of ownership consolidation they became majority owners of the most profitable ones. Workers became co-owners in companies that were less profitable and burdened by internal conflicts, as well as labour-intensive companies (Simoneti et al. 2004; Stanojević 2014). Then, a rapid increase in Slovene wages following the protests strengthened local consumption and helped the Slovene economy recover. Finally, the affirmation of organised labour as a politically influential actor reinforced the pursuit of the managed floating currency standard that was already put in place. A fixed exchange rate regime was politically unacceptable as this would imply a direct confrontation with strong labour (Bembič 2014). However, Keynesian neo-corporatism favouring the export-oriented sector and recognising a significant role of the state (in the industry, the financial sector and for public infrastructure) also secured the material basis of the post-Yugoslav local elites composed mainly of autochthon managers (Krašovec 2013b), groups of the conservative (nationalist) cultural establishment and reformed political successors of the Alliance of Socialist Youth of Slovenia (Centrih 2014), which would secure the integration of Slovenia into Euro-Atlantic organisations (Močnik 2006).

This institutional design, however, could not be reproduced without the ongoing capacity of Slovene managers and the state to secure the accumulation of capital in relatively new conditions of capitalist competition. The latter was a consequence of the introduction of "hard-budget constraint" (Stanojević 2010) and the integration of local enterprises as sub-contractors into the international production networks of central EU economies, mainly the German one (Andreff 2007; Myant/Drahokoupil 2011). And as Slovenia even deepened its semi-core international profile through the machinery-complex exports structure without significant influence of FDI – as was the case in the Viségrad group – one may say that the accumulation strategies were indeed quite successful (see Figures 1 and 2). Without a doubt, the chosen macroeconomic policy represented an important factor in making Slovenia the CEE leader in the drive for capitalist accumulation (Bohle/Greskovitz 2012; Myant/Drahokoupil 2011); but in the last instance the state capacity to implement its policies depended on various strategies of labour exploitation.

Figure 1: Inward FDI stock (% of GDP) in CEE countries. Source: UNCTAD, UNCTADstat.

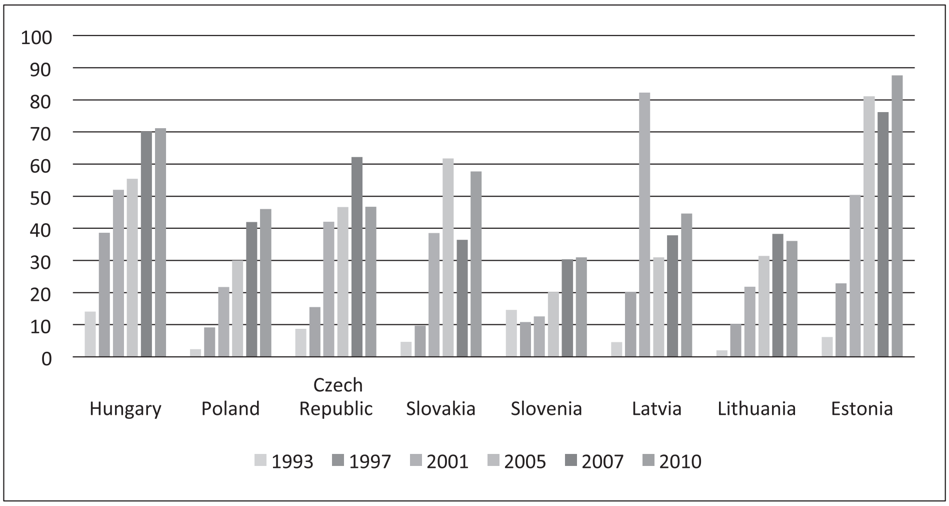
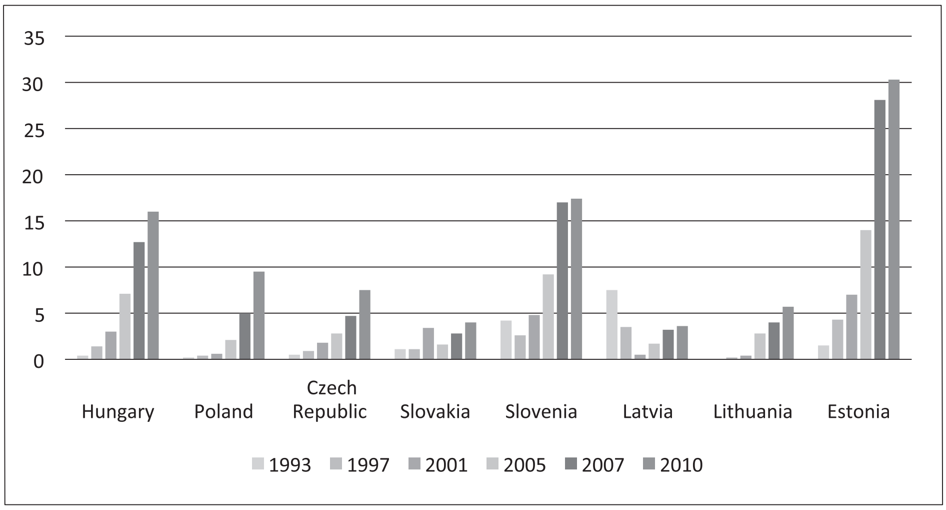


Figure 2: Outward FDI stock (% of GDP) in CEE countries. Source: UNCTAD, UNCTADstat.



The established neo-corporatism provided an institutional framework for a specific bargain between managers and workers and resulted in a dual labour market. In exchange for secured and stable employment , the unions agreed to extreme intensification of work and a progressive decline in wage growth (Stanojević 2010). But the competitiveness of enterprises could not be secured without an accompanying emergence of highly flexible, temporary, low-paid and precarious jobs mainly for students and workers from other Yugoslav regions. The regulation of student work, which is part of the Yugoslav "heritage", represents an anomaly in the European context. During the transition, this institution was transformed into one of the main and most frequently used sources of not only flexible and cheap but also accessible and qualified labour force because it is only partly included in the (formal) Labour Market Act (Trbanc 2005). Immigrants from other regions of ex-Yugoslavia were generally employed in the construction sector, which actually was one of the most prosperous "transition" sectors. The modernisation of infrastructure was necessary to improve the competitiveness of Slovene productive units, and the state launched an important highway construction project. But it also provided a migrant labour regulative framework that allowed for labour standards to be below "neo-corporatist Slovene standards" and helped to keep workers' wages constantly low (Breznik 2005). This international accumulation strategy based on cheaper labour from other regions of ex-Yugoslavia is not "realised" only on the formal territory of the Slovene capitalist economy, but also outside of it. Slovene enterprises appeared as CEE pioneers in relocating their labour-intensive activities and developing access to cheaper labour in the less developed successor states of former Yugoslavia (Damijan 2004). This "hyper-babbagisation"[4] of Slovene production further disciplined local labour, particularly in the traditional industry (Bohle/Greskovitz 2012).

It is important to note that Slovene exploitation strategies were founded on the Yugoslav self-management "heritage". Not only that the progressive delocalisation of Slovene production was premised on trade patterns and networks that used to exist among productive units within Yugoslavia. The intensification of work was facilitated by the fact that the majority of the labour force, who had been "socialised" in Yugoslav self-management, manifested specific affiliation to enterprises and perceived them as "their own enterprises". Indeed, due to this socio-political effect of the organisation of labour processes in post-war socialist industrialisation, in socialist Yugoslavia and the Slovene transition to capitalism "managers were often able to persuade workers to work for lower wages, thereby shifting the burden onto the workers' households and their networks in order to save the companies" (Centrih 2014: 32).

The political compromise underpinning the Slovene transition was premised upon the belief that integration into the EU would help improve the living standard of the local population. However, after more than ten years of capitalism, with the on-going intensification of work, fragmentation of labour markets and growing social inequalities, workers recognised that such promises were highly unrealistic (Stanojević 2010). This first EU disillusionment resulted in a government change

4 Selwyn (2014) defines "hyper-babbagisation" as a process designed to fragment and raise the rate of exploitation of labour through a geographically dispersed subdivision of the labour process. Charles Babbage (1835) was a political economist who argued that the division of labour could both lead to general productivity increases and cut wage costs.

bringing a right-wing government into power. Partly as a consequence of the country's integration in the EU and the EMU, a new spatial capital accumulation strategy emerged in Slovenia.

3.4. The "disarticulation" of Slovene capitalism (2004-2008)

The period of the right-wing coalition started with another affirmation of the mobilisation power of organised labour. Though a hugely popular rally in 2005 did stop the implementation of (the majority of) the announced radical neoliberal reforms, it could not, however, prevent the increasing reliance of Slovene production on the inflow of foreign financial capital flooding the national space of capital accumulation after the accession of the country to the EU and EMU.

To create its proper economic base, the governing coalition launched an important privatisation programme of national enterprises. This second wave of privatisation was economically based upon cheap loans from the EU financial markets that local banks gained access to with Slovenia's entry into the EU. Institutionally, it was secured by the state ownership of the banking sector. It was mostly the managers who had the political capital to easily get approval for massive loans accorded by the national banks. Not only did this "selective privatisation" (Stanojević 2014) reconfigure the economic elite networks that had until then underpinned the Slovene transition (Žerdin/Mrvar 2007); the newly established "tycoon" managers could hardly be fit into Schumpeter's classification of entrepreneurs, either creative or adaptive (Selwyn 2014). Rather than looking to explore new market opportunities or to technologically improve the competitiveness of Slovene enterprises, political networking and selective redistribution of wealth seemed to be the main preoccupations of the newly established economic elite (Stanojević/Klarić 2013). However, the rising foreign indebtedness of the Slovene economy was not linked only to the second wave of privatisation. The new spatial strategy of capitalist accumulation based on dependent EU financialisation also fuelled the local real estate boom and consumption, although the latter in less pronounced ways than elsewhere. Indeed, the vast majority of bank loans went to the corporate sector. When Slovenia entered the euro zone in 2007, the growth of loans to the corporate sector reached 29.8%, whereas average growth in 2001-2004 was about 13%. Corporate debt was around 100% of GDP in 2005, but reached 144% in 2010, which was substantially above the EU average (Kržan 2014).

It is important to note that the increasing indebtedness of the Slovene economy was further fuelled by pro-cyclical government policies. For instance, the fiscal reform that lowered taxes for the rich, encouraged investments while diminishing potential budget revenues. With the partial conversion of external into internal debt and the selling off of some state assets in the enterprises, the government provided the local banks additional liquidity (Bembič 2014). If in 2005 Slovenia still had a positive international position, at the end of 2008 net external debt reached €11.5bn (see Figure 3). A mid-2000s economic boom that peaked in 2007 with a 7% GDP increase (the highest rate since 1995) was therefore based mainly on unprecedented growth of loans (Kržan 2014). Similar to other peripheral countries of the EMU or the EU, access to additional financial capital contributed insignificantly to the (technological, human capital) improvement of the local productive base. But, as already mentioned, the Slovenian banking sector was not overflowed by foreign, mostly German, Austrian and Belgian, banks as was the case in other CEE countries (Raviv 2008). The major mediators of the new spatial reconfiguration of Slovene (finance) capital were local private or state banks (Myant/Drahokoupil 2012) (see Figure 4).

Figure 3: Net external debt of Slovenia (% of GDP). Source: Bank of Slovenia.

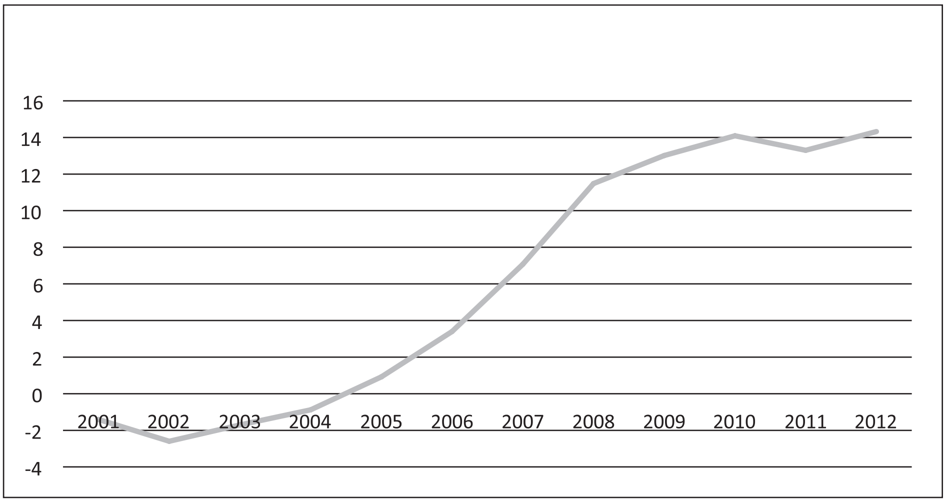
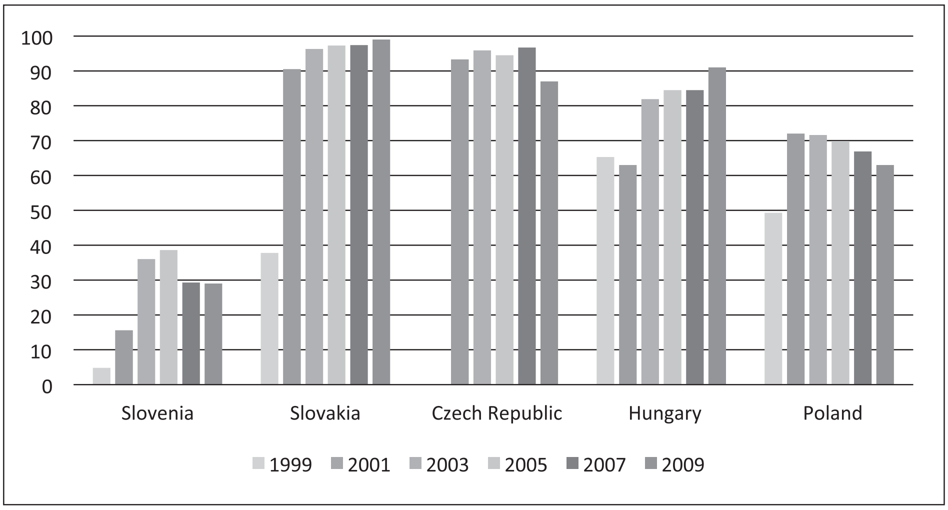


Figure 4: Market share of foreign-owned banks (% of total assets) in selected CEE countries. Source: Raiffeisen CEE Banking Sector Report 2004, 2008, 2014.



It was mostly the workers (and their families) that had to "back" the increasing corporate indebtedness that intensified the already intense competitive pressures resulting from the EU and the EMU (Stanojević 2014). This holds true particularly for the Slovene citizens integrated into the neo-corporatist regime, who were now less and less secured by welfare provisions. In the years when Slovenia was known for an impressive average GDP growth of 5.5%, the neoliberal reforms of the social security system together with the tax reforms actually caused the rate of poverty to rise to 12.3% in 2008 (Leskošek 2012: 108).

Using the terminology of the dependency school's authors (Kay 1991), it is possible to say that during this period the specific interplay of external and internal dynamics and the EU peripherisation rationale of "development of underdevelopment" "disarticulated" the Slovene capitalism that had until then been secured by the post-Yugoslav self-management coalition between reformed unions, pro-EU political leadership and export-oriented economic elites tied to the dominant markets of the EU. Besides the reconfiguration of the post-Yugoslav networks of political-economic elites, there was progressive institutional erosion of the neo-corporatist regime: government decisions were less and less in line with the central institution of the Slovene bargaining system; the main representative of capital was transformed into a voluntarily organisation (2006); and the "transitional" industrial unions had to face falling membership, growing segmentation of the labour market etc. (Stanojević 2010). Finally, regarding the development of the productive base, the increasing indebtedness particularly fuelled the development of the least "attractive" – and potentially profitable – sectors and the most "speculative" ones. In the first year of the crisis, employment in the textile industry decreased by 47%, in the wood processing industry by 25% and in the construction sector by 23% (Drenovec 2013).

4. Conclusion

Already before the crisis, several internal contradictions of the Slovene development eroded the Slovene "national capitalism" model. It seems, however, that in the post-2008 crisis period a particular intertwining of international and national conditions brought the Slovenian development model closer to that of other post-socialist CEE countries.

In the context of the systemic crisis of global capitalist development, the Slovene economy was badly hit by the credit crunch and the falling foreign demand for physical goods that revealed its strong dependence particularly on Germany. The crisis of "real economy" transformed into a crisis of the banking sector, which evolved into a public finance crisis (Kržan 2014). In 2009, exports shrank by almost 19%, industrial production by more than 16%, and GDP by 8%. The inflow of cheap loans from abroad diminished, and the bubbles in the construction and real estate sector burst. In 2010, the situation was made worse when the Slovene Central Bank increased the capital requirements for the banks. This contributed to a further contraction of lending activity. The credit crunch pushed many enterprises into bankruptcy and aggravated the losses on the banks' balance sheets. Unemployment started to rise swiftly: from 4.4% in 2008 to an unprecedented 9.6% in 2013. As in most countries, the private losses were mainly socialised by the Slovene state, which contributed to the sovereign debt crisis. The latter was mostly a result of declining tax revenues due to the fall in economic activity, especially after 2011, government interventions in the banking sector and – after 2011 – the financial turmoil in the EMU. Between 2009 and 2013, the government debt to GDP more than doubled from 22% to 54.4% in 2013 (Kržan 2014; Bembič 2014).

The local socio-economic crisis coupled with unstable international financial markets and EMU public budget constraints further "disarticulated" post-Yugoslav labour, capital and state within the sovereign Slovene territory. The first years of the crisis were also characterised by high political instability and a repeated succession of centre-left and centre-right party coalitions. However, regardless of declared political differences, the centre-left "Bratušek" government preventing Slovenia from succumbing to Troika conditionality, and a strong and long wave of protests (at the end of 2012, beginning of 2013), the governments succeeded in implementing reforms in line with the authoritative austerity measures programme – the so-called "Berlin consensus" (Becker/Weissenbacher 2014). The governments radically cut the Slovene welfare system and (public sector) wages, lowered taxes on profits and income, and launched the "bad bank" project. Finally, after the meeting of then Prime Minister Bratušek with Merkel, in June 2013 an impressive privatisation program was introduced to sell off some of the most profitable state enterprises and strategic sectors to foreign bidders (Stanojević 2014; Bembič 2013).

Although it is still too soon to draw any final conclusions about the new spatialisation strategy of the Slovene state, it is possible to say that rather than a success story, Slovene post-Yugoslav capitalist development represents a "laggard" in the process of the making of the EU post-socialist periphery. Rather than a factor that would restrain the development of Slovene capitalism, its socialist past is its main driving force that seems to progressively dismantle in the process of peripherisation of the post-socialist economies within the EU space of capitalist production.

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Jon Las Heras

Framing Labour Strategies in the European Automotive Industry: Any Inflexion Point Ahoy?[1]

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Abstract

The article argues that European organised labour needs to set a historical inflexion point so that the current global neoliberal mode of regulation can be overcome. Globalisation is understood as a historical process orchestrated, notwithstanding its multiple contradictions, by global capital against workers' "national buttresses" that took form during the post-war mode of regulation. Such buttresses "empowered" labour and improved its social condition. Neoliberal transformation has taken place both at a macro and micro level undermining such power. Understanding labour's position within an increasingly globalised productive process is indispensable in order to analyse its multiple reactions and critically engage with them. That labour's response has been insufficient is clear after the recrudescence of neoliberalism after the 2008 financial crisis. In this article I shall first provide a historical explanation on the transformation of western countries towards a global neoliberal mode of regulation that placed macroeconomic and fiscal policies under capital's hegemony. Also, I will account for the transformations on the organisation of the labour process that has fragmented and dispersed productive activities with a special focus on the European automotive industry. Secondly, I will outline organised labour's reactions against globalisation's pressures at corporate level, as well as the problems that such workers have encountered in order to construct an effective counter-hegemonic movement in Europe. Finally, I will conclude by arguing that current trade union initiatives are not sufficient to regain the ground that has been lost and may reproduce more of the same; it is indispensable for national and transnational trade unions to reconsider their historical role if they plan to build a counter-hegemonic block that challenges the current "political lock-in".

1. Global Capital Overwhelming Labour

1.1. Transformation of the Mode of Regulation: From National-Fordism to Global Neoliberalism

Since the 1980's developed capitalist economies have experienced a steady process of transformation. The *post-war mode of regulation,* which lasted from the early 1950s to the late 1970s, has been labelled as a historical phase within capitalist development wherein western countries (basically Western Europe, US, Australia and New Zealand) embraced the Keynesian / Social Democratic project and experienced a buoyant and successful economic *age d'or* (Bowles et al. 1990; Kotz et al. 1994). The combination of persistent productivity growth rates, real wage growth

1 Earlier versions of this paper were presented at the 5th IIPPE Conference in Naples in September 2014, and at the Jean Monet Euro Crisis Conference in Vienna in February 2015. I would like to thank the discussants and participants for useful and critical comments.

rates, government regulation of financial, commodity and labour markets, and the widespread fiscal redistributive policies that underpinned the rise of the Welfare State, secured a relatively stable economic environment that fostered long-term economic growth, full-employment and decent working conditions. That period has been analysed and described as a period in which the *balance of forces* between capital and labour was relatively even, and thus the capacity of the economies to grow steadily was possible after many of the economic contradictions that derive from the lack of effective demand had been counterbalanced (Glyn 1990).

Organised labour was capable of influencing macroeconomic and redistributive policies at state level (partially but decisively) (Streeck 2012), as well as it was, to a certain extent, capable of limiting managerial power in the workplace when organising the labour process (see e.g. Martinez Lucio et al. 2014). However, Thacher's and Reagan's turn to re-commodifying strategies empowered capital (industrial and mainly financial) vs. organised labour, strategically displacing the latter from any regulatory power by subjugating fiscal, monetary and labour market policies to "sound finance" and "market discipline" (see e.g. Martinez Lucio and Blyton 1995). It was combined with a de-industrialising process of some of the largest manufacturing regions that transformed the "Fordist" labour process into "Toyotism" and the "Knowledge Economy" (see Pulignano et al. 2009). Neoliberalism reduced labour's collective power both at the workplace and on the labour market, permitting to establish systematically real wage growth rates below productivity growth rates that increased the share of capital in the national economy; an economised *regime of accumulation* sustained weak effective demand pools thereafter with increasing private debt till the bubble burst in 2008 (McDonough et al. 2010).

The European Union and the European Monetary Union, following the same line, have been portrayed as the most representative supra-national institutional conglomerates underpinning a *European neoliberal mode of regulation* (e.g. see Cafruny and Ryner, 2007; van Apeldoorn et al. 2008) wherein financial capital has become hegemonic (Toporowski 2013). The structural transformation was combined with clear signs of uneven accumulation patterns between the northern core and the southern periphery, which necessarily mirrored each other in order to balance corporatist and mercantilist pacts, and preferred "nationalist" positions (Bellofiore et al. 2011; Becker and Jäger, 2012; Lapavitsas et al. 2012; Laskos and Tsakalotos 2013). Put briefly, the European Integration process has been paramount to the erosion of the Keynesian National Welfare State and become a trailblazer for neoliberal transformation (see also Jessop 2002).

1.2. Corporate Transformation of the Labour Process: Rise of Global Value Chains

In relation to one of the most crucial moments in the capitalist accumulation process, i.e. the labour process (Braverman 1974), since mid-1960's US Transnational Corporations (TNCs), following Japanese corporate strategies, sliced their supply-production chain in search for "low cost and capable suppliers inshore and offshore, forcing other local, national and international capitals to replicate such strategies if they were to survive" (Robinson, 2004: 20). The labour process was steadily fragmented, breaking the typical Fordist mass production system and transforming into a *fluid and disperse* network *within and between* geographical spaces.[2]

According to academic literature the strategy of global capital amounts to (see Contractor et al. 2010):

(1) Compute the optimal disaggregation or *slicing the value chain into as many constituent pieces as organisationally and economically feasible* and,

(2) take decisions on *how each slice should be allocated* organisationally (outsourcing) and geographically (offshoring).

In that sense, Globalisation has not just implied greater rates of foreign trade, FDI and international financial flows but (and maybe more importantly) a simultaneous qualitative change on the "decentralisation [of production] and the centralisation of [corporate] command" (ibid: 1420). The purpose for such a strategy being to take advantage and exploit different wage costs and working conditions of countries, sectors and workplaces (Flecker et al. 2008).

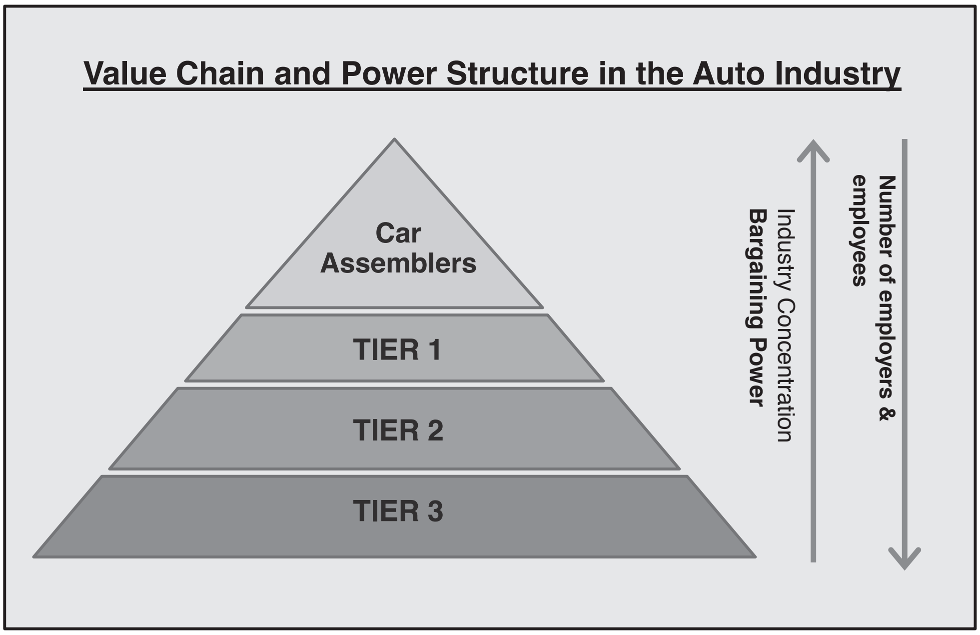
The structure of the firm and its governance has changed accordingly, moving from the typical "integrated firm" to more flexible structures in order to retain solely those activities that add greater value. A centrepiece of the Global Value Chain (GVC) analysis tries to understand how *corporate power* can actively shape the distribution of profits and risks in an industry. Empirical findings show that in fragmented markets GVCs are being supplanted by greater "strategic collaborations" where governance is concentrating into the top node producers of the value chain which have a geographical constitution and which exercise structural bargaining power over larger and smaller nodes on the GVC, thus regulating how much profit each stage of the chain should yield (Gereffi, 2014: 16).

It can be said that the automotive industry, which is the largest manufacturing industry in Europe in terms of value added and R&D expenditure (European Commission, 2014), "went European" from the late 1970's onwards accompanying the generalised process of globalisation (Bilbao-Ubillos, 2010). "[T]he automobile industry represents a typical example of a producer driven value chain in which large manufacturers coordinate the production network. This involves a central role played by leading firms in establishing and coordinating investment based vertical networks of component suppliers" (Pavlinkek and Janak 2007: 134-135; see also Sturgeon et al. 2008: 307-309). A Three-Tier structure can be distinguished amongst the carmakers' suppliers (Pavlinek and Janak 2007: 139-140): Tier-1 is co-responsible for designing, developing and assembling the different modules and subsystems that will be finally assembled at the Original Equipment Manufacturer (OEM) plants (e.g. Volkswagen or Ford); Tier-2 is responsible for assembling smaller

2 Global Value Chain (GVC) literature provides a theoretical framework that explains the qualitative changes that transnational (note: not international) production processes have experienced (for a literature review see Gereffi 2014; Gereffi and Lee 2012).

and less complex components that are only part of a particular module; Tier-3 will produce those components of lowest value added that haven't been produced by superior Tiers (see Figure 1).

Figure 1: Value chain and corporate power structure in the automotive industry



Source: Own source

The customer-supplier relations amongst different Tiers and OEMs are based upon uneven power relations wherein the extremely concentrated structure of the industry gives a small number of leading firms an extraordinary amount of bargaining power throughout the GVC (Sturgeon et al. 2008). OEMs' huge purchasing power can force suppliers to accommodate their idiosyncratic standards, information systems and business processes to their will. Meanwhile, the heavy engineering work on vehicle development, where conceptual designs are translated into the parts and sub-systems, remains centralised and is developed by the OEM and/or the 1st Tier suppliers. There is a polarisation and oscillation on the relationship between the automotive suppliers and the OEMs, with highly capital-intensive automated systems that yield large surpluses at the top of the GVC, and more labour-intensive activities that produce lower value added at the bottom (Rugraff 2012).

1.3. Transformation of Industrial Relations: Erosion of Labour's Collective Power

A group of Critical Political Economy scholars suggest that the important conceptual starting point for the Global Value Chain analysis should be labour's dual ontology: (1) as *abstract labour,* the fundamental economic category that helps us understand the production of surplus value under capitalism and (2) labour as *political agency,* workers' political response to the wage-labour contract that takes the form of either political submission or contestation in the form of trade unions and other forms (either informal or formal) of collective action. The latter are sentient actors/organisations that represent more or less particular groups of workers within such systems of production and which make specific decisions that shape and co-constitute the very process of production (Levy, 2008; Cumbers et al. 2008; Rainnie et al. 2011). The centrality of labour in capitalism "only becomes self-evident" during moments of labour political action, in the form of strikes and other labour tactics that are able to question and modify the GVCs (Cumbers et al. 2008 :372). "Consequently, labour must be treated both as the *ultimate source of value* but also as a *subjective [political] agent* in both individual and collective terms" (Rainnie et al. 2011:161; emphasis added). Put briefly, GVCs will be the result of both economic and political action that responds to a complex and historically specific process of inter and intra class struggle. The wage-contract and the working conditions will be transformed into the image of capitalist accumulation dynamics and the challenging strategies that organised labour may portray.

The decentralisation of workers' bargaining power moves in parallel to the transnationalisation of production while the negative effects that outsourcing and offshoring processes have had on labour's collective power are far from being disputed:

> "Employment relations and the quality of work are *strongly influenced by the position of a company in a value chain* or production network, by the degree of dependence between firms and by the way power operates in supply relations. [...] Reorganisation of the value chain weakens labour and destabilises industrial relations institutions. There are two reasons for this. First, outsourcing accelerates tendencies towards deregulation and decentralised bargaining, because suppliers and service providers are less likely to be covered by [company, sector or territorial] collective agreements. Second, similar to internationalisation and relocation of work, outsourcing options change the power relations between employers and labour and thus puts pressure on the workforce to make concessions on their employment conditions" (Flecker 2009: 252-253; emphasis added).

It is not surprising to see that working conditions, wage-differentials, unionisation and collective bargaining coverage rates strongly correlate to the structural position that the company embodies in the value-chain (Banyuls and Lorente 2010). The decentralisation of production is accompanied by a disempowerment of the workforce and the deregulation of economic activities, leading not just to economic downgrading[3] but also to political exclusion:

> "The atomisation of companies and the dispersion of workers are major obstacles to the unions' capacity for organisation and collective representation. However, the major problem is that this dispersion involves a clear differentiation of employment conditions. In the central companies and the first-level suppliers, trade union organisation is still high, work tends to be stable and wages relatively high, while flexibility is based on agreement. In companies that carry out activities of low added-value, the work is more unstable and far worse paid, and industrial relations are far more individualised. [...] Thus, the main objective [and challenge] is to homogenise working conditions through collective action" (Caprile 2000: 16-17).

3 For example, component supplier workers in Spain earn on average 25%-30% less than car assembly workers (Alaez et al. 2009: 53).

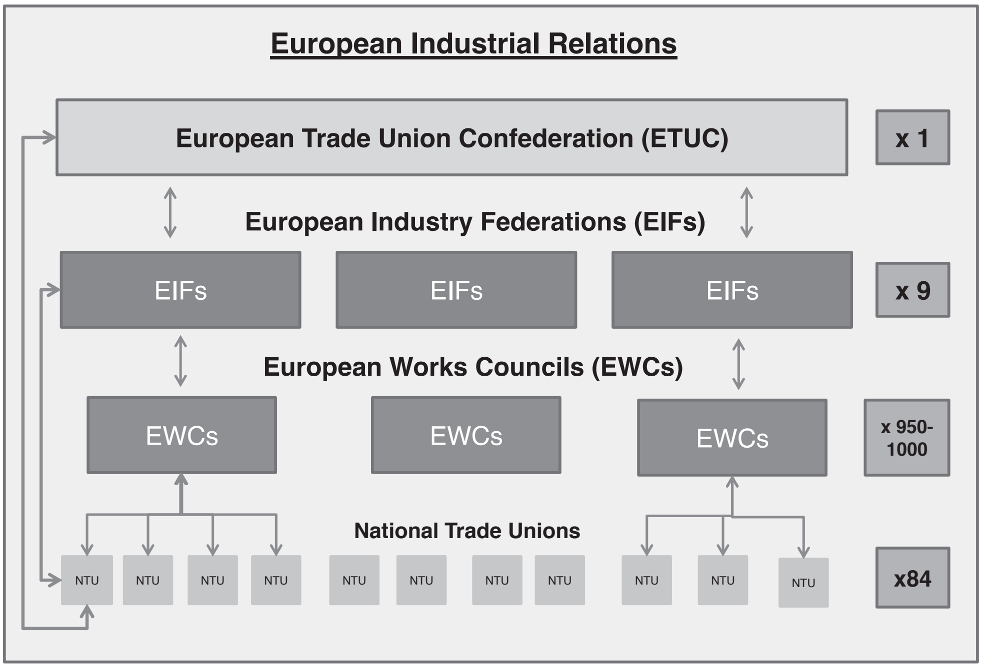
Capital’s structural power over labour increases as it moves further from the “core workforce”: “greenfield” investments in “developing” geographies embody lower levels of vertical integration, greater technological domination and, thus, a greater power of global capital over a fragmented and unorganised labour force (Doellgast and Greer 2007). In the following section, we will analyse European labour’s major responses to the outlined globalisation trends and the problems associated with them.

2. European Labour’s Responses to Value Chain Transformation

2.1. Transnational Coordination and the European Industrial Relations

Back in the early 1970s first steps were taken to urge national unions to coordinate with other national unions because production was going “borderless”. The result of such transnational strategy has been a relatively rapidly built and complex set of European Industrial Relations (Glassner and Pochet 2011: 11; see Figure 2 for a schematic representation). The European Trade Union Confederation (ETUC), the European Industry Federations (EIFs) and the European Works Councils (EWCs) are the major “forums” wherein union cooperation is created, developed and deepened at the European level (Larsson, 2012: 153).

Figure 2: Scheme of European industrial relations



Source: Own source

At the top of European Industrial Relations, the ETUC represents the “interests of the workers” on a more general basis. It focuses on building up the social dialogue with European employers and the European Commission while it tries to establish a broader strategy for the EIFs and the member national trade unions. At a lower stage, we find the EIFs that coordinate national trade unions in specific industries. The EIFs have actively been engaged in setting transnational trade union coordination networks and collective bargaining patterns at transnational company level, i.e. the European Works Councils (Da Costa et al. 2012). Just below, the EWCs will represent the material foundation of the EIFs' attempt to set information and dialogue spaces within TNCs. EWCs bring active national trade unions and factory work councils together in order to exchange information or render consulting practices on an annual or bi-annual basis. At the national and local level we find national trade unions, which still retain most of the collective bargaining powers vis-a-vis the factory managers and company representatives out of the very structural composition of the value chains and the limited regulatory framework.

Several pioneer historical events have become examples of European transnational solidarity practices (see Erne 2008; Bernaciak 2013):

(1) The "Doorn declaration" of 1998, where several national trade unions of continental Europe defended the equalisation of productivity growth rates with real wage growth rates;

(2) The "political guidelines" adopted by the European Metalworkers Federation (EMF) in 2005 and 2006 to build cross-country effective responses to transnational restructuring processes;

(3) The first transnational solidarity actions (e.g. strikes) in the automotive industry out of the coordination of national trade unions through EWCs (and with the supervision of the EMF) against corporate pressures to play off assembly plants against each other in order to achieve capital investments.

However, despite the abovementioned steady construction of an EIR, there are five major problems that European trade unions face at the time of building transnational solidarity (Köhler and Gonzalez Begega 2008; Larsson 2012; Bernaciak 2013):

(1) The predominance of national and local micro-corporatist interests in opposition to a cross-country solidaristic "European identity";

(2) The decentralisation problems that the "Open Method of Coordination" and the limitations of the EWC Directive create to build an overarching regulatory framework with effective bargaining power vs. transnational capital;

(3) The relatively voluntary nature of the EIR, and the incapacity of European TUs to implement disciplinary sanctions to those national TUs that do not commit to the transnational agreements;

(4) Ideological, cultural and institutional differences among national trade unions and national industrial relations systems that impede an effective coordination;

(5) Lack of economic and organisational resources to develop and coordinate both national TUs as well as the ETUC, ETUFs, and EWC.

These problems linked to the large number of different (and often opposing) trade union strategies, as well as to the continuous threat of mobile capital, slow down and even block transnational labour solidarity labour practices. This obviously undermines labour's capacity to deal with global capital because the scales of power are hierarchically ordered in favour of capital. Thus, it can be argued that the European Industrial Relations are still under construction and that they will be the object of further trade union discussion and action during the forthcoming years.

2.2. Including Outsourced Activities

Four main difficulties have been indicated when it comes to building a common strategy, an overarching "homogenising" umbrella, among vertically fragmented workers along the value chain, and which pose serious problems to organised workers and trade unions (Dorigatti 2013: 38-44):

(1) *Trade unions act on a time lag,* they are reactive and respond after the fragmentation has already taken place. First, structural differentiations are implemented and the construction of the common interest appears as a secondary reactive process;

(2) *Representation of workers' interests is not straightforward,* works councils and trade unions need to process and select the different particular interests that capitalist transformation generate;

(3) Organised workers may sometimes *need to dissociate themselves from direct rank-and-file preferences* wherein micro-corporatist interests may emerge, building a common trade union agenda above particular/individual interests;

(4) *Difficulty to build a homogeneous entity and ideology* within the workforce: works councils and trade unions can achieve their goals only to the extent they are able (both strategically and instrumentally) to set aside dividing grievances and concentrate on common demands which foster collective organisation. Different workers' and trade unions' identities/ideologies may lead to more inclusive or exclusive political programs to which works councils and trade unions respond.

Nevertheless, several strategies and actions have been recorded in the automotive industry that reflect on workers' responses to capital's globalising power and which show different degrees and forms of conflicting views on corporate domination:

(1) *Inaction and acceptance* of managerial decisions to transform the labour process;

(2) *Propose alternative measures* to managerial strategies and reduce (and even decide upon) the extension and depth of the transformation of the labour process. Very often it has led workers and trade unions to embrace the corporate understanding of competitiveness, becoming "brothers in arms", and signing "competitiveness pacts" wherein workers accept downgrading their economic and working conditions (wage pacts or flexibility pacts) in order to protect their employment (Freyssinet and Seifert, 2001; Zagelmeyer, 2001; Sisson, 2001);

(3) *Collective actions to stop and/or restrict* restructuring processes through worker mobilisations while simultaneously challenging managerial power (see Stewart et al. 2008; for examples of UK autoworkers);

(4) *Organising subcontractors and supplier parks* by creating workers councils, or empowering the existing ones, and unionising members of the lower levels of the value chain (see Doellgast and Greer 2007; Dorigatti 2014; for examples of IG-Metall in Germany)

(5) *Defend employment levels and working conditions in outsourced companies:* extending regulation (rights) and collective agreements to subcontractors in order to permit corporate fragmentation but maintaining existing working conditions. This has been partially accomplished through the enforcement of International and European Framework Agreements (although quite limited and basic on the range of rights that they defend, see Telljohann et al. 2009) or by signing specific political pacts that brought the whole fragmented workforce under the same collective agreement (an interesting example was FIAT's collective agreement in the Melfi plant in Southern Italy; see Pulignano 2005).

The adoption of one or the combination of different strategies will be the result of the collective power of labour within a specific accumulation structure and *mode of regulation* (Pulignano and Stewart 2013) on the one hand; and as the articulation of a specific political and ideological strategy vs. global capital (Dorigatti 2014) on the other. Irrespective of workers' collective power within a given environment, organised workers' understanding of the problem will thrust collective (in) action into one direction or the other, reproducing or transforming contemporary accumulation dynamics. Nevertheless, it seems that hitherto, the number of successful actions of oppositional workers remains limited.

3. Concluding Remarks: Further Neoliberal Entrenchment and Labour Submission?

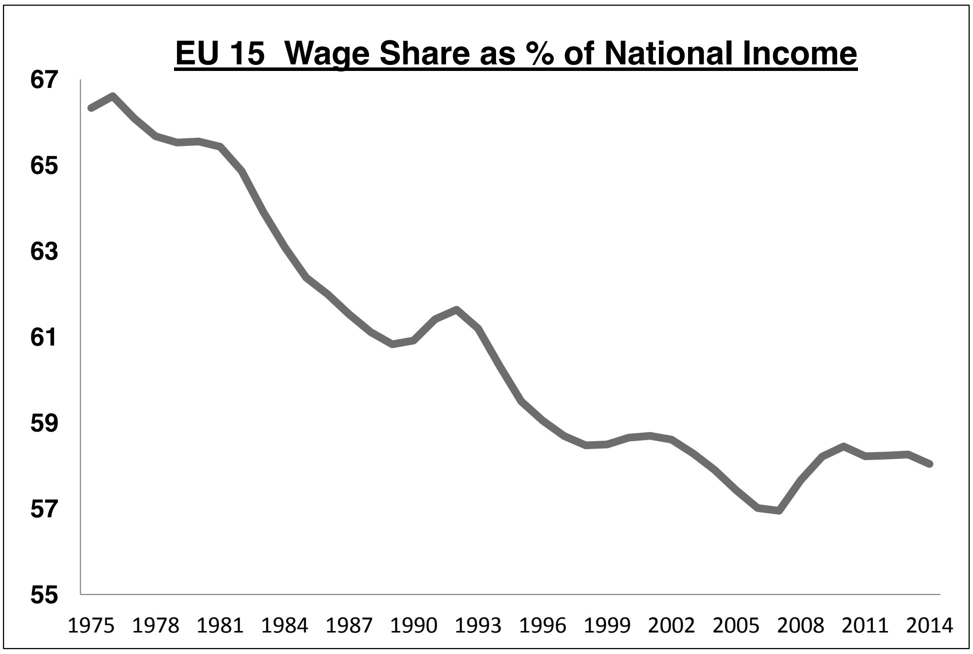
As we have seen in section 2, workers, trade unions and other civil society organisations have organised mobilisations and coordinated networks in order to respond against globalisation pressures in the workplace. I has also been noteworthy that the European Anti-Austerity Strike of November 14th 2012 gathered millions of workers from Portugal, Spain, Italy, France and Greece in simultaneous demonstrations against wage cuts and government spending cuts. Nevertheless, in the light of neoliberal entrenchment in fiscal policy and labour market reforms that further commodify the reproduction of labour and fragments the industrial relations framework (see Schulten and Mueller 2013; Hermann 2014; for a review on different European countries reforms after the crisis erupted), trade unions and labour organisations have remained generally passive, submissive and on the defensive (Urban 2012).

More specifically, in those sectors exposed to global capital pressures, e.g. the automotive sector, “crisis micro-corporatist” pacts have been widespread (Banyuls and Haipeter 2008; Köhler et al. 2012). Factories facing relocation threats to “low cost geographies” or the outsourcing of their lower value added activities to cheaper subcontractors have imprinted a “pragmatic” mentality on workers’ imagination. Thus, labour responses that were presented in section 2 and which steadily gathered moment throughout the 90s and 2000s have been “cooling down” for a while.

Unfortunately, Critical Political Economy can argue that postponing European labour’s counterattack to global neoliberalism reproduces neoliberal accumulation dynamics which have widely been warned against.

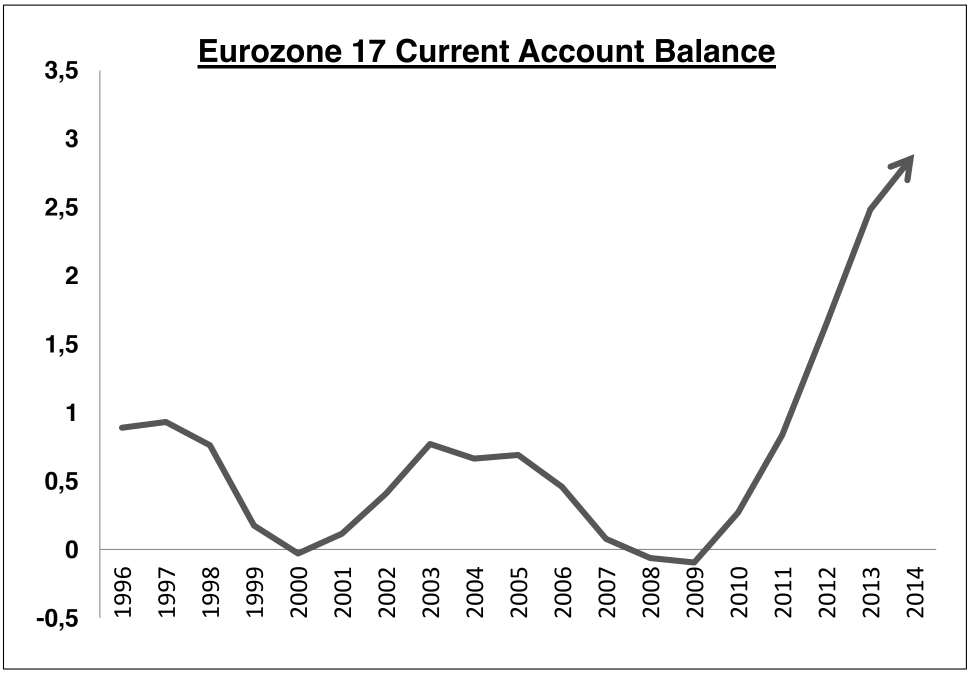
On the one hand, “competitive corporatism’s” reaction to the crisis on setting real wages significantly below productivity growth rates further diminishes the wage share in national income; this in turn reduces consumption’s share on the effective demand pool that sustains capital investments while it also generates social welfare (see Figure 3 below). Assuming Europe to be a demand led mode of accumulation, fiscal retrenchment and further distribution of income to capital underpins economic stagnation, greater unemployment rates and greater social inequality (Stockhammer et al. 2007; Onaran et al. 2011; Stockhammer 2012). The reification of European mercantilism that continuously seeks market outlets elsewhere results in: (1) the “importation of profits and the exportation of unemployment” from the least competitive regions and sectors and (2) the accumulation of huge trade imbalances at the global scale (see Figure 4 below; Kalecki 1954: Chapter 3; and U.S. Treasury Department, 2013; for a worrying report on Europe’s, and specially Germany’s, international trade strategies).

Figure 3: EU 15 wage share as percentage of national income



Source: AMECO Database. Author's calculations: moving average 3.

Figure 4: Eurozone 17 current account balance



Source: AMECO Database. Author's calculations: moving average 3.

On the other hand, the Social-Democratic ideology underlying European corporatism tries to build an inter-class-alliance with capital in which the balance of forces is clearly uneven in favour of capital (Upchurch et al. 2009). Legitimising the rules of the game in capitalism, and especially those currently put by global capital, disempowers an increasingly fragmented working class politically and ideologically.

The transformation of the German industrial relations paradigm is a great example: the post-war protective umbrella of sector collective agreements has being seriously undermined as smaller German corporations had to camouflage within new and more competitive global market patterns (Streeck 2008; Lehndorff 2012; Heeg 2014). In this case, IG-Metall's strategy becomes historically significant due to its strategic position within German and European industrial capital. Whether IG-Metall continues embracing "competitive micro-corporatist strategies" which systematically downgrade wages and working conditions, or if it sets a historical inflexion point (or what others have called an "active veto" strategy) through the promotion of a pan-European working class identity, will substantially affect other national and transnational labour strategies and move the balance towards more or less corporatism (Baynuls and Haipeter 2008).

Entrenching corporatist practices (irrespective of their geographical scale) exclude those who cannot benefit from them, reproducing and fostering the political division within the working class while, contradictorily, they postpone the moment in which "core labour" will also be defied by capital accumulation (Panitch 1981). After all, even the most productive labourers are a "cost on management's balances" that shall be cut sooner or later.

Fearing frontal opposition to governmental and managerial discourses only prolongs a forecasted economic and political agony. On the contrary, trade unions, organised workers and social movements may need to reset their ideological and strategic maps: "audacity, more audacity, always audacity" so that they can get the power that they have lost during the last decades back (Amin 2013). This, obviously, will not occur through a new post-modern marriage with capitalism, as if by erecting and organising new complex industrial relations (nationally and internationally) that underpin "Green and/or Knowledge Based Economies" would improve workers' structural position *per se.* It will neither happen after a short term enraged convulsion of a marginal part of the workforce nor from a conscious, but self-limited, subversive student movement. The processes of *transnational class organisation* that have been explained in section 2 are as indispensable as building up the still fragile, but growing, *subversive global class consciousness* which, if combined with the former, may *coordinate effective "glocal" class struggles* that shall empower the world wide working class and reset the rules of the game. As it has been argued by Bieler and Lindberg (2010), new forms of organisation and collective actions require parallel innovations in collective identity, thus the historical and dialectical constitution of a global working class. Alas, as long as labour doesn't realise its global condition and bite the multiple forms of global capital that hold the lead tight it will remain its guide-dog.

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