

# The European economy: Stagnation/liberalization or reconstruction/reimagination?

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Euro-Memo Group's 21<sup>st</sup> Annual Conference on Alternative  
Economic Policy in Europe

Addressing Europe's Multiple Crises:

An agenda for economic transformation, solidarity and democracy

24-26 September, Roskilde University, Roskilde, Denmark

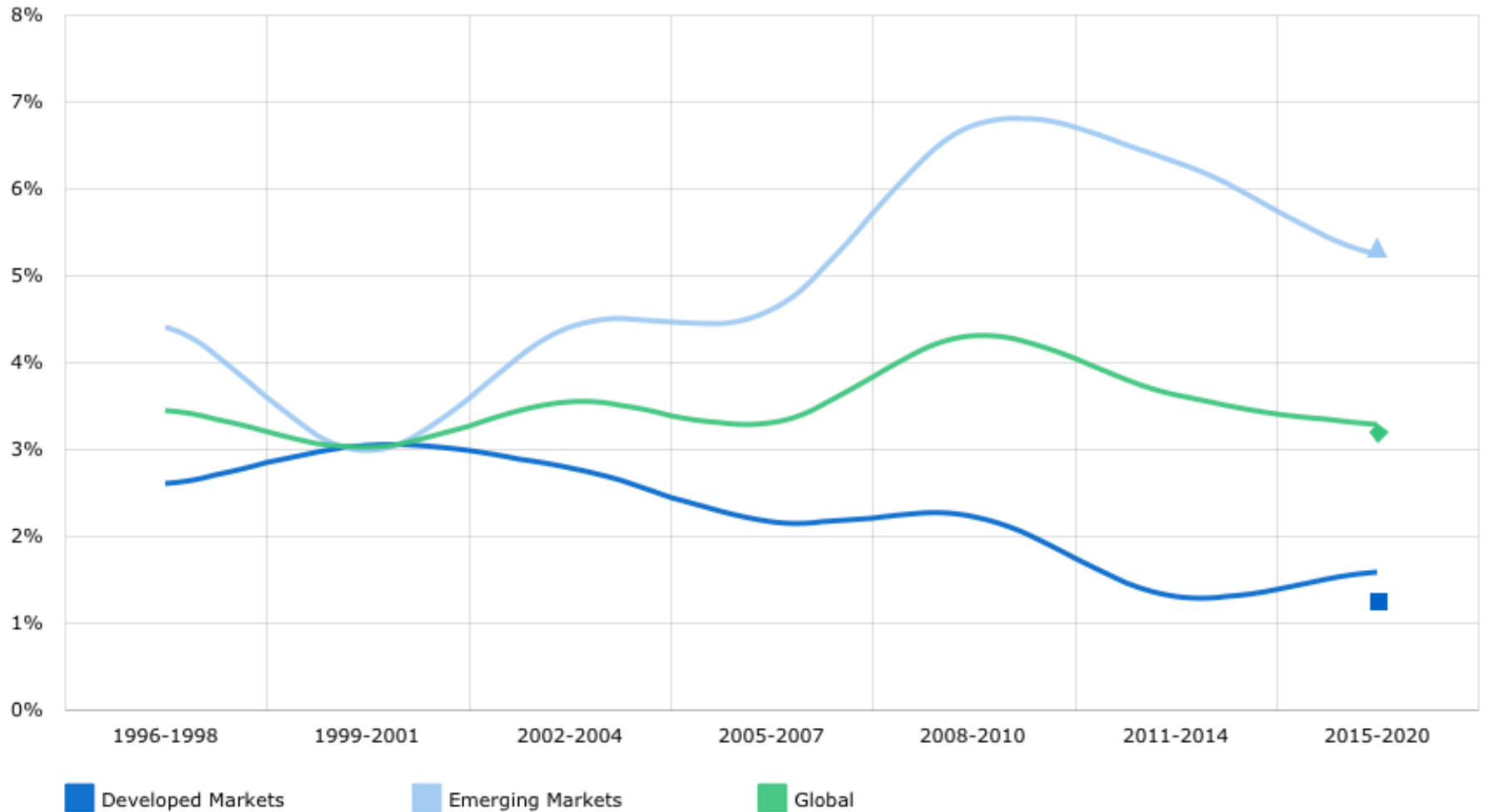
# The European economy: Stagnation/liberalization, or reconstruction/reimagination?

1. State of the global macroeconomy
2. The trajectory of the European economy
3. Recent economic policies: fiscal policy, monetary policy, financial policies
4. Critical evaluation, policy directions

# 1. State of the global macroeconomy

- Overall trajectory of global growth
- China slowdown
- Commodities price collapse
- Brazil economic crisis
- Drivers of US economic growth – new housing boom, renewed ‘consumer of last resort’ behavior?
- Failure of “Abenomics” in Japan
- “India shining” in debate

## Potential Output Growth Headed Lower, Especially in Emerging Markets; Developed Markets Subdued



Source: IMF, Morgan Stanley Research forecasts

Taken from “Global Macro: Pros and Cons of Getting Stuck in the Middle,” Morgan Stanley Research, September 11, 2015; section entitled “Emerging-Market Drag.”

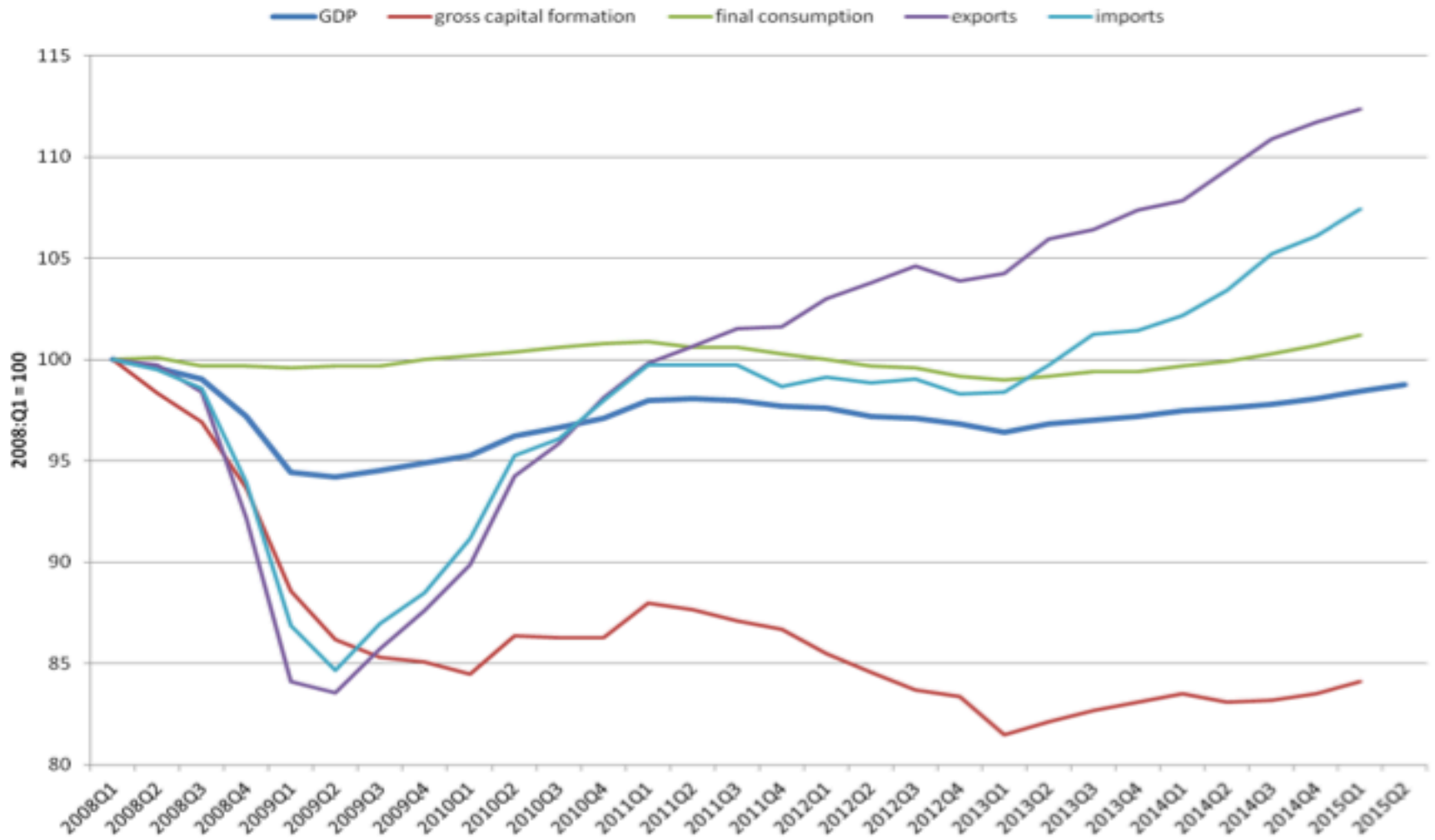
# IMF Economic Outlook, July 2015 revision to April 2015 estimates

**Table 1. Overview of the *World Economic Outlook* Projections**

(Percent change unless noted otherwise)

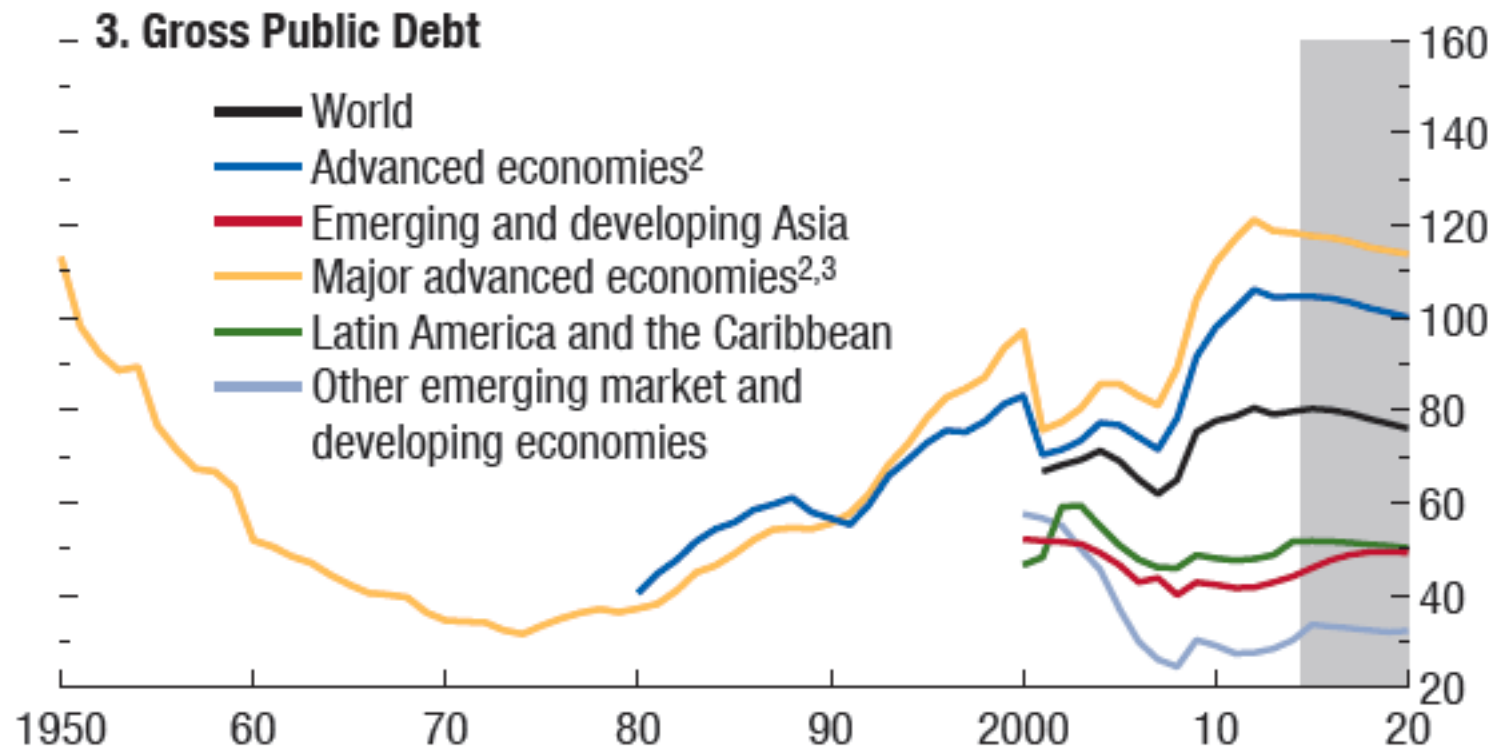
	Year over Year						Q4 over Q4		
	2013	2014	Projections		Difference from April 2015 WEO Projections 1/		2014	Projections	
			2015	2016	2015	2016		2015	2016
<b>World Output 2/</b>	<b>3.4</b>	<b>3.4</b>	<b>3.3</b>	<b>3.8</b>	<b>-0.2</b>	<b>0.0</b>	<b>3.3</b>	<b>3.3</b>	<b>3.7</b>
<b>Advanced Economies</b>	<b>1.4</b>	<b>1.8</b>	<b>2.1</b>	<b>2.4</b>	<b>-0.3</b>	<b>0.0</b>	<b>1.7</b>	<b>2.2</b>	<b>2.3</b>
United States	2.2	2.4	2.5	3.0	-0.6	-0.1	2.4	2.4	2.8
Euro Area 3/	-0.4	0.8	1.5	1.7	0.0	0.1	0.9	1.8	1.6
Germany	0.2	1.6	1.6	1.7	0.0	0.0	1.5	1.8	1.5
France	0.7	0.2	1.2	1.5	0.0	0.0	-0.0	1.7	1.3
Italy	-1.7	-0.4	0.7	1.2	0.2	0.1	-0.4	1.2	1.3
Spain	-1.2	1.4	3.1	2.5	0.6	0.5	2.0	3.3	2.2
Japan	1.6	-0.1	0.8	1.2	-0.2	0.0	-0.9	1.7	1.3
United Kingdom	1.7	2.9	2.4	2.2	-0.3	-0.1	3.2	2.2	2.1
Canada	2.0	2.4	1.5	2.1	-0.7	0.1	2.5	1.0	2.3
Other Advanced Economies 4/	2.2	2.8	2.7	3.1	-0.1	0.0	2.6	2.8	3.1
<b>Emerging Market and Developing Economies 5/</b>	<b>5.0</b>	<b>4.6</b>	<b>4.2</b>	<b>4.7</b>	<b>-0.1</b>	<b>0.0</b>	<b>4.7</b>	<b>4.3</b>	<b>5.0</b>
Emerging and Developing Asia	7.0	6.8	6.6	6.4	0.0	0.0	6.9	6.6	6.4
China	7.7	7.4	6.8	6.3	0.0	0.0	7.3	6.8	6.3
India 6/	6.9	7.3	7.5	7.5	0.0	0.0	7.5	7.3	7.5
ASEAN-5 7/	5.1	4.6	4.7	5.1	-0.5	-0.2	4.8	4.7	5.2
Emerging and Developing Europe	2.9	2.8	2.9	2.9	0.0	-0.3	2.6	3.5	3.0
Latin America and the Caribbean	2.9	1.3	0.5	1.7	-0.4	-0.3	1.2	-0.1	2.1
Brazil	2.7	0.1	-1.5	0.7	-0.5	-0.3	-0.2	-2.1	2.3
Mexico	1.4	2.1	2.4	3.0	-0.6	-0.3	2.6	2.5	3.0
Middle East, North Africa, Afghanistan, and Pakistan	2.4	2.7	2.6	3.8	-0.3	0.0	...	...	...
Saudi Arabia	2.7	3.5	2.8	2.4	-0.2	-0.3	1.6	2.7	2.6
Sub-Saharan Africa	5.2	5.0	4.4	5.1	-0.1	0.0	...	...	...
Nigeria	5.4	6.3	4.5	5.0	-0.3	0.0	...	...	...
South Africa	2.2	1.5	2.0	2.1	0.0	0.0	1.3	1.5	2.4

Figure 1. The "recovery" in perspective



Source. Eurostat, Euro area 19, chain-linked volumes, seasonally adjusted and adjusted data by working days

From: **Euroland Has No Plan B: It Needs An Urgent Recovery Plan**  
by [Jörg Bibow](#) on 7 September 2015, *Social Europe*.



Source: IMF staff estimates.

<sup>1</sup>Euro area countries (Greece, Ireland, Italy, Portugal, Spain) with high borrowing spreads during the 2010–11 sovereign debt crisis.

<sup>2</sup>Data up to 2000 exclude the United States.

<sup>3</sup>Canada, France, Germany, Italy, Japan, United Kingdom, United States.

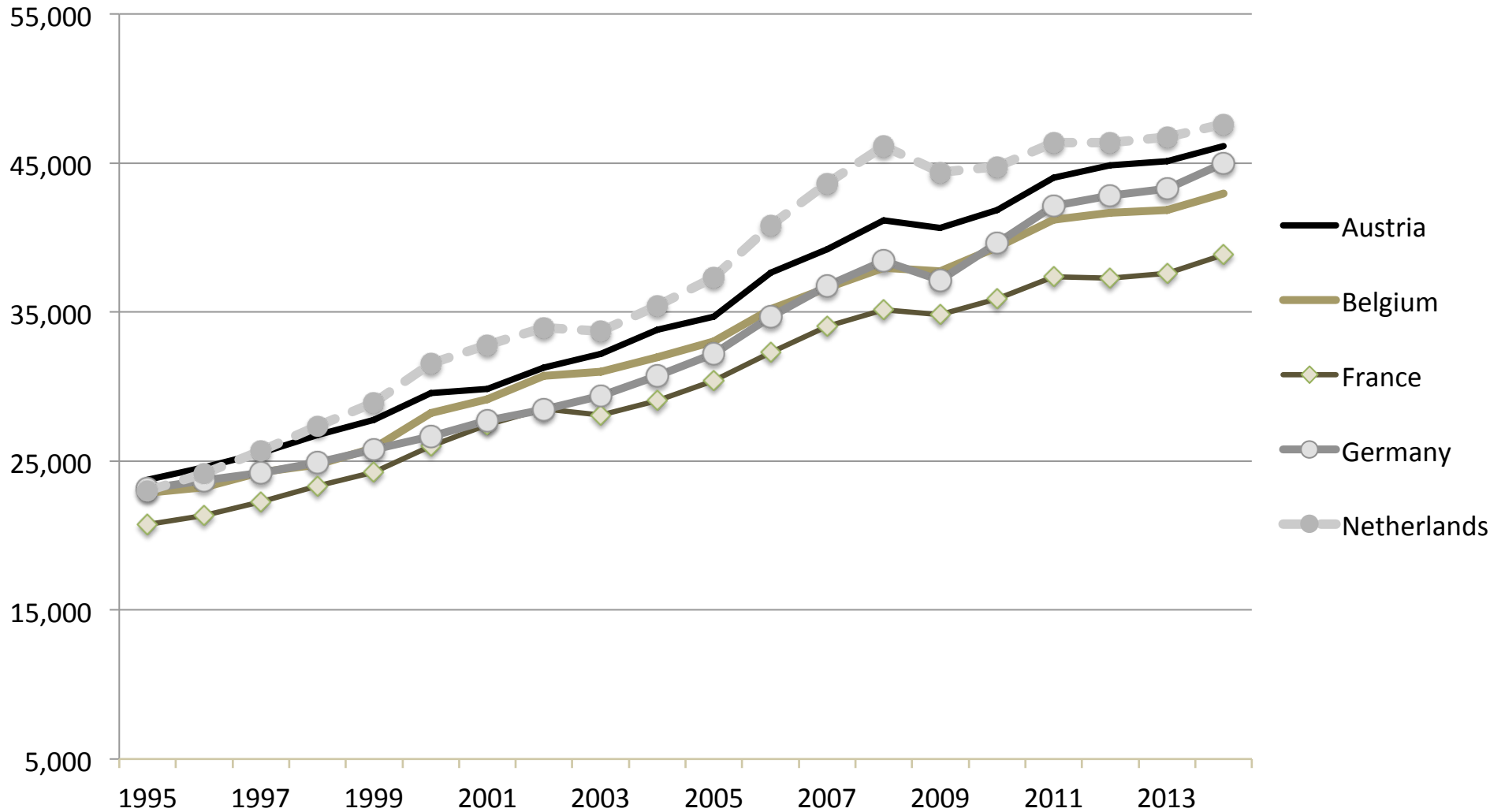
## 2. The trajectory of the European economy

- GDP growth
- What about lost output/employment growth?
- Two approaches:
  - Keynesian: Aggregate demand components in European economic growth
  - Industrial policy: the drivers of European economic growth

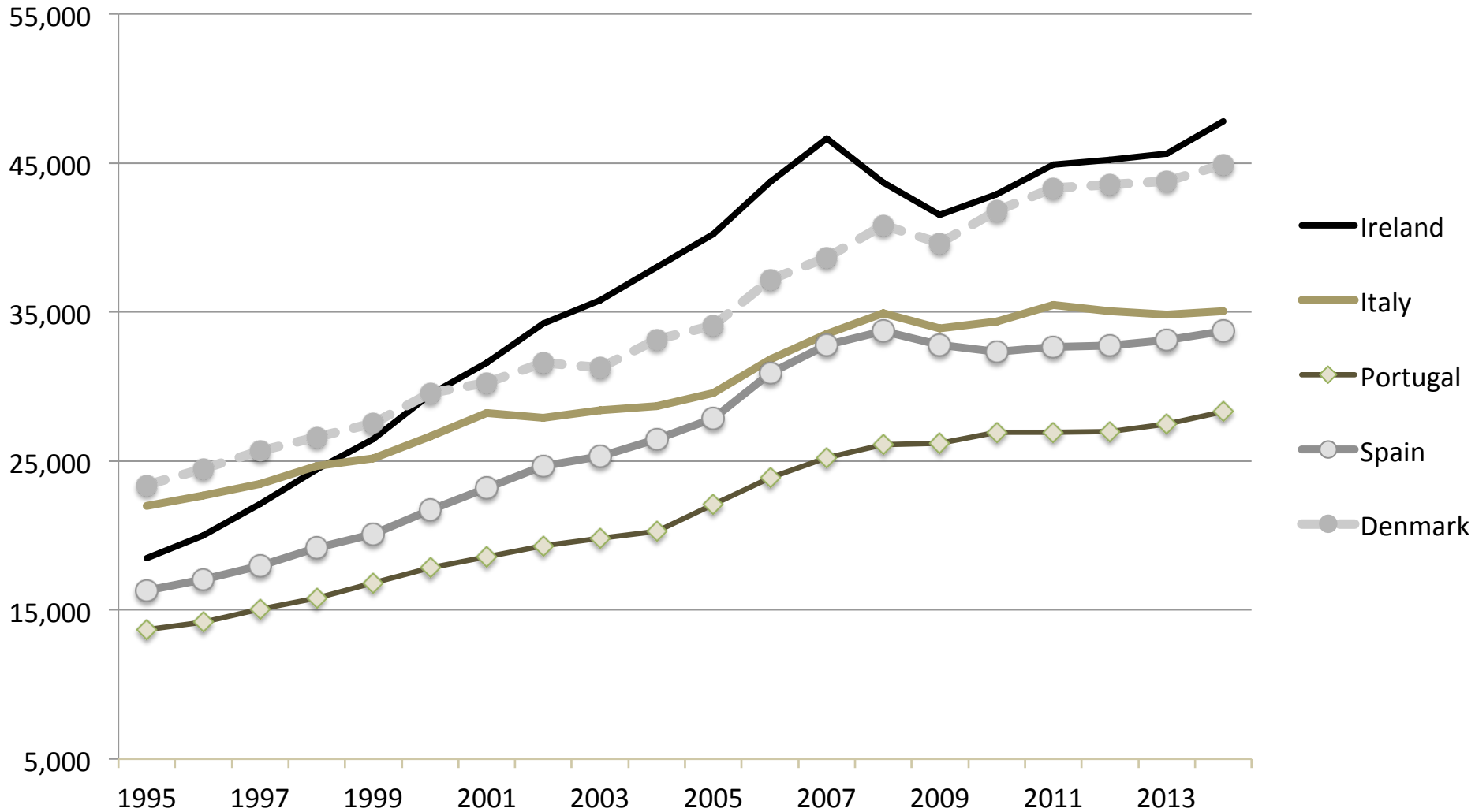


All data presented in this format: OECD.

## GDP per capita (in nominal US \$), annual data, 1995-2014 North-central EMU Nations

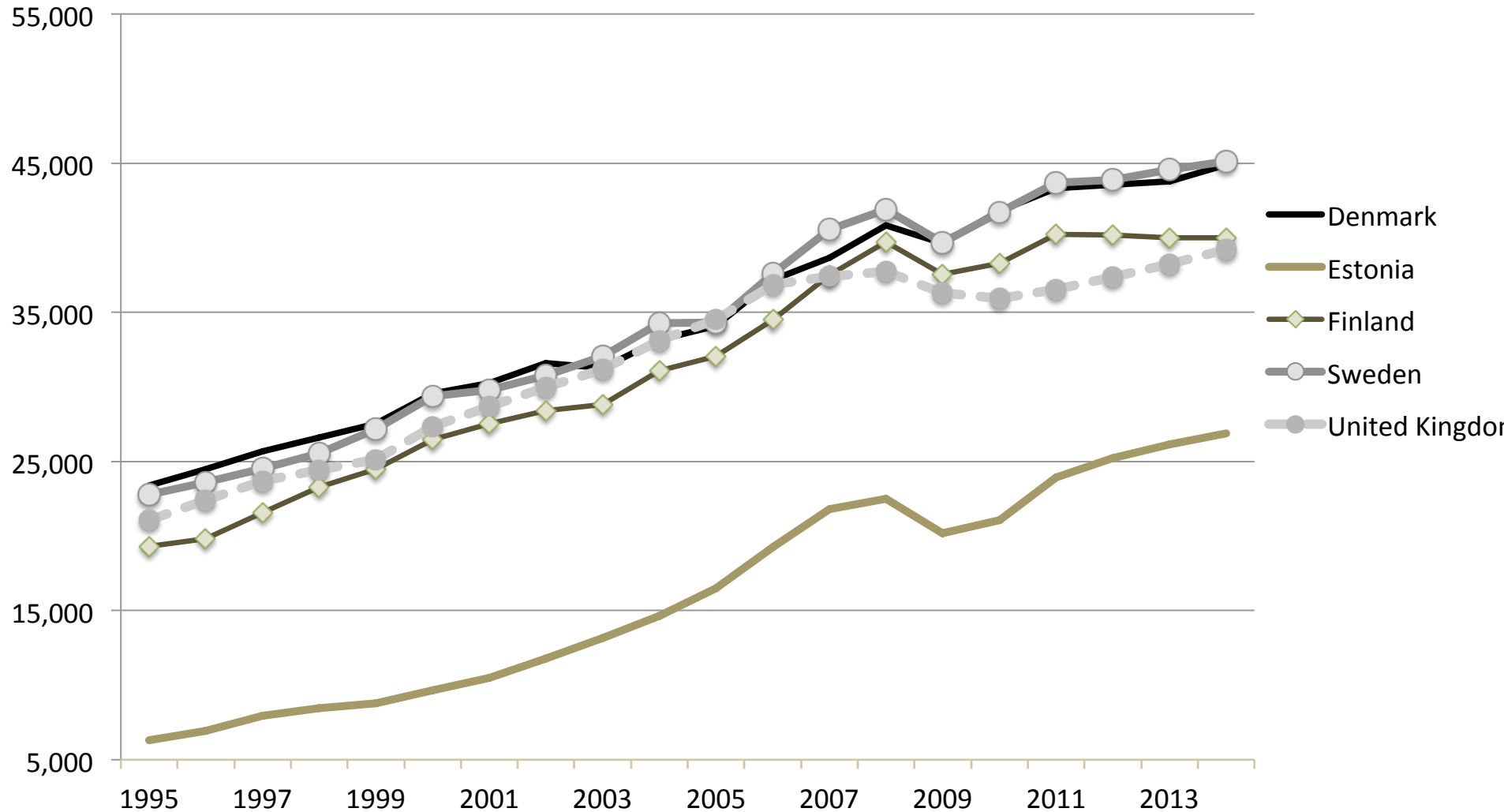


GDP per capita (in nominal US \$), annual data, 1995-2014  
GIPSI EMU Nations



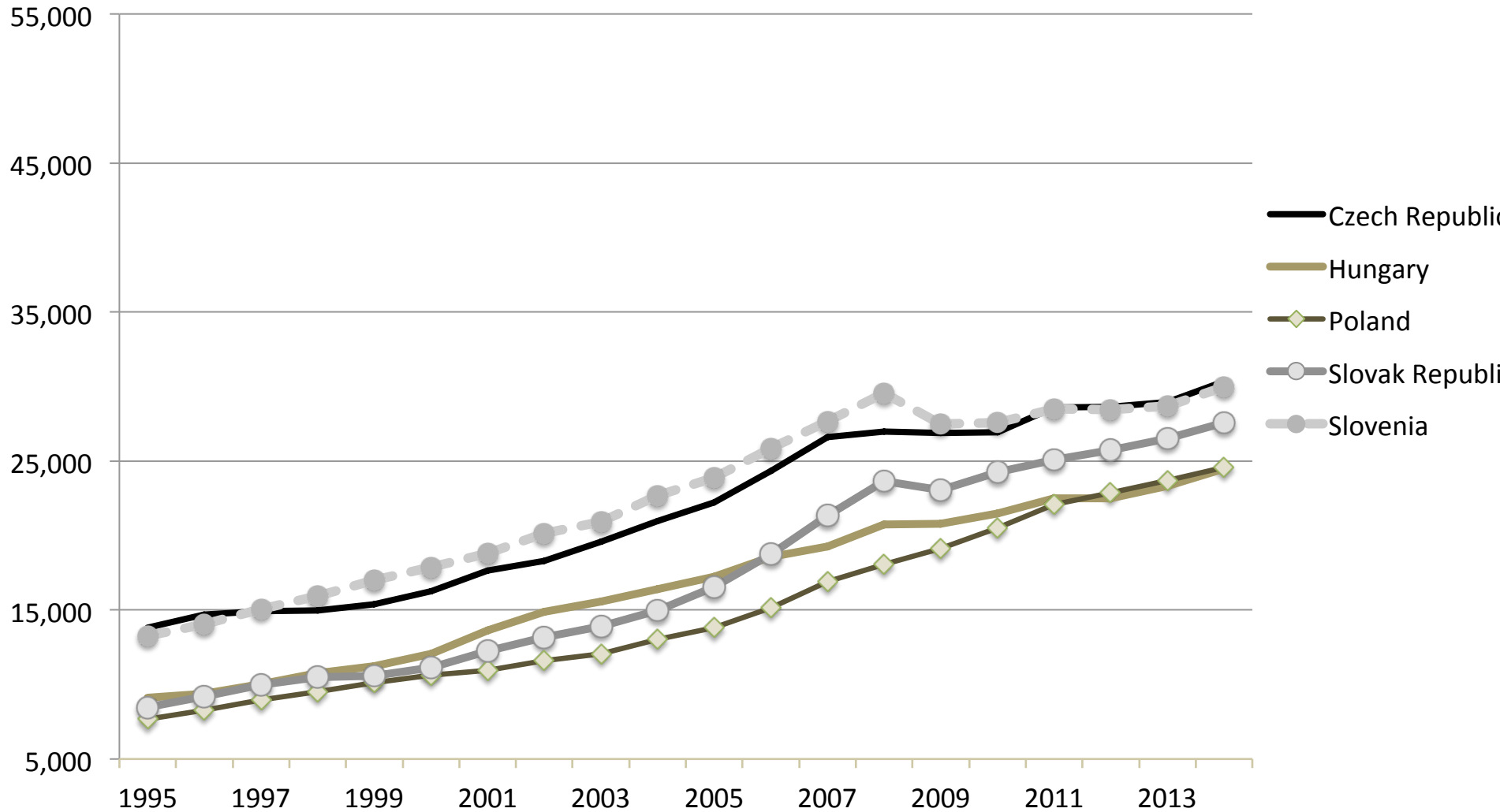
# GDP per capita (in nominal US \$), annual data, 1995-2014

## Northern EU Nations



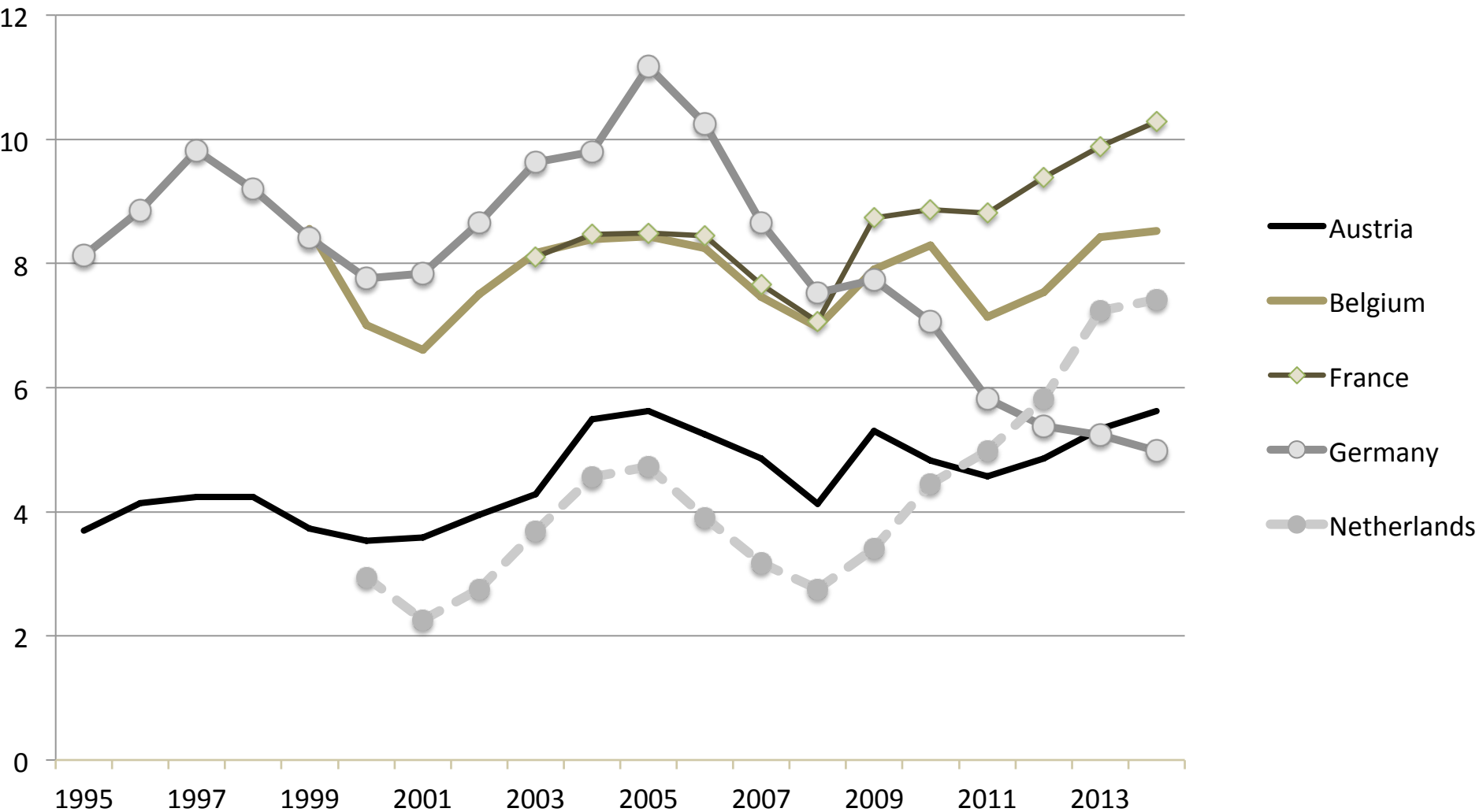
# GDP per capita (in nominal US \$), annual data, 1995-2014

## Central-Southern EU Nations

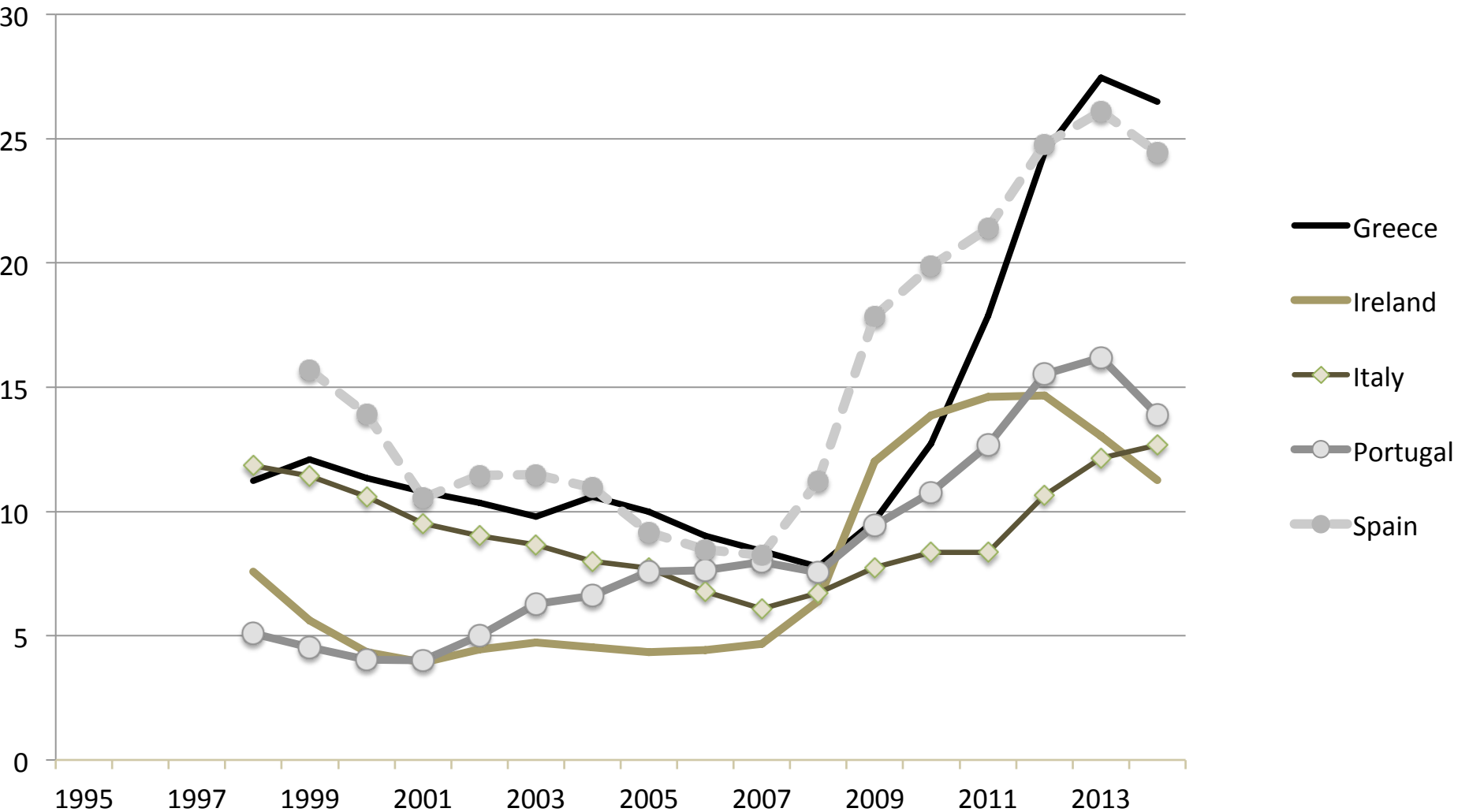


# Unemployment as % of labor force, annual data, 1995-2014

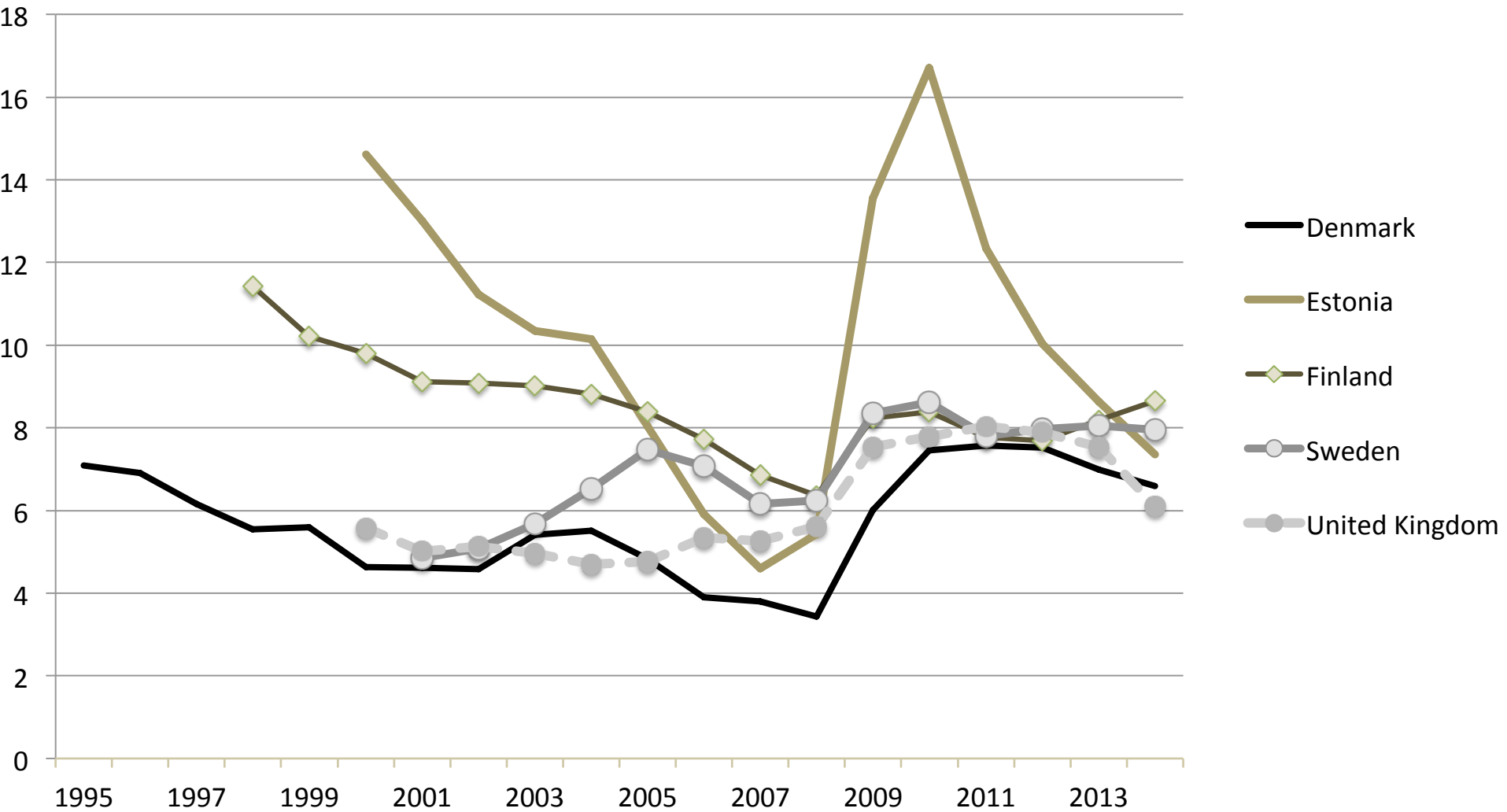
## North-central EMU Nations



Unemployment as % of labor force, annual data, 1995-2014  
GIPSI EMU Nations



Unemployment as % of labor force, annual data, 1995-2014  
Northern EU Nations



# Unemployment as % of labor force, annual data, 1995-2014

## Central-Southern EU Nations

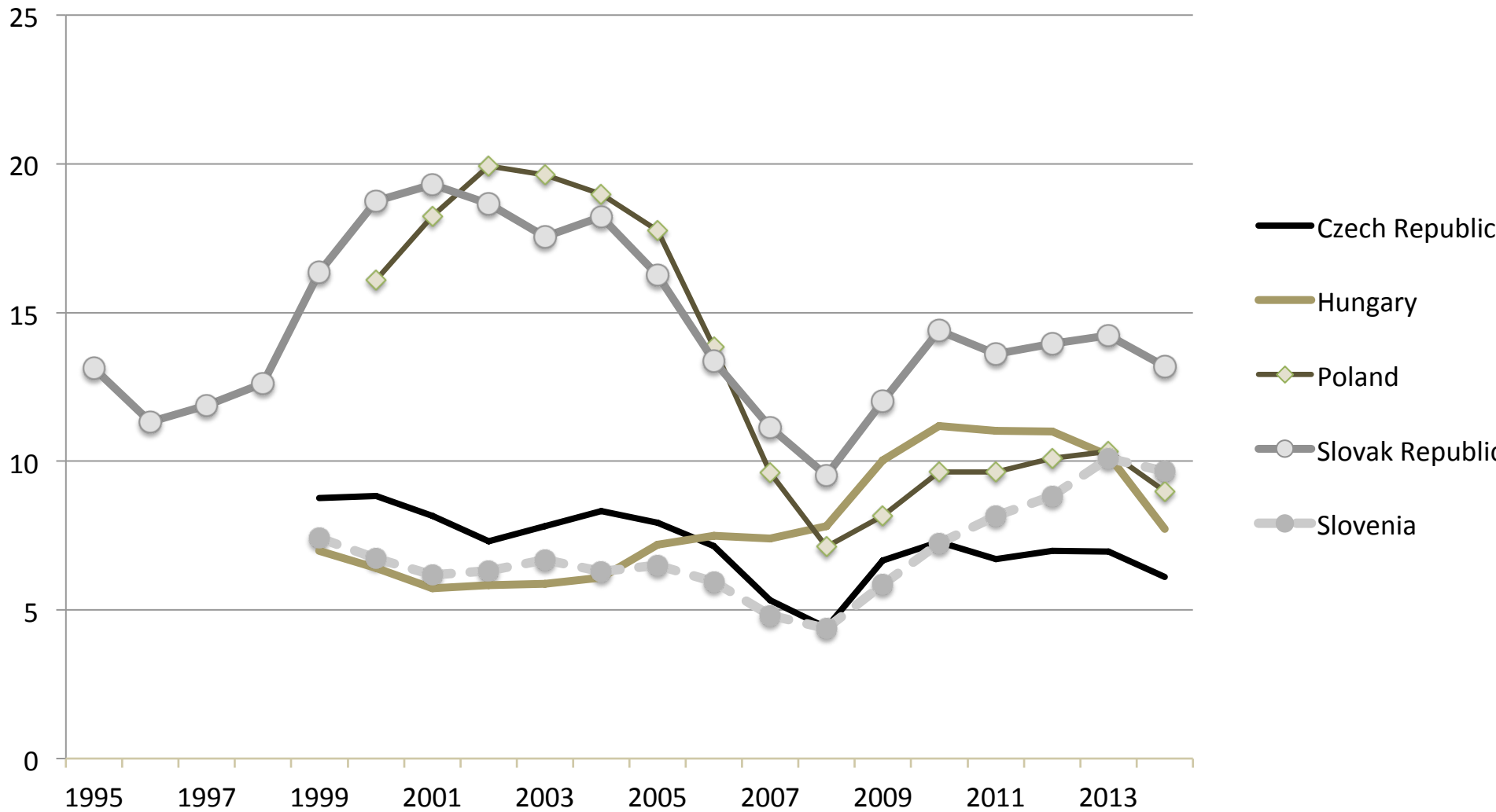
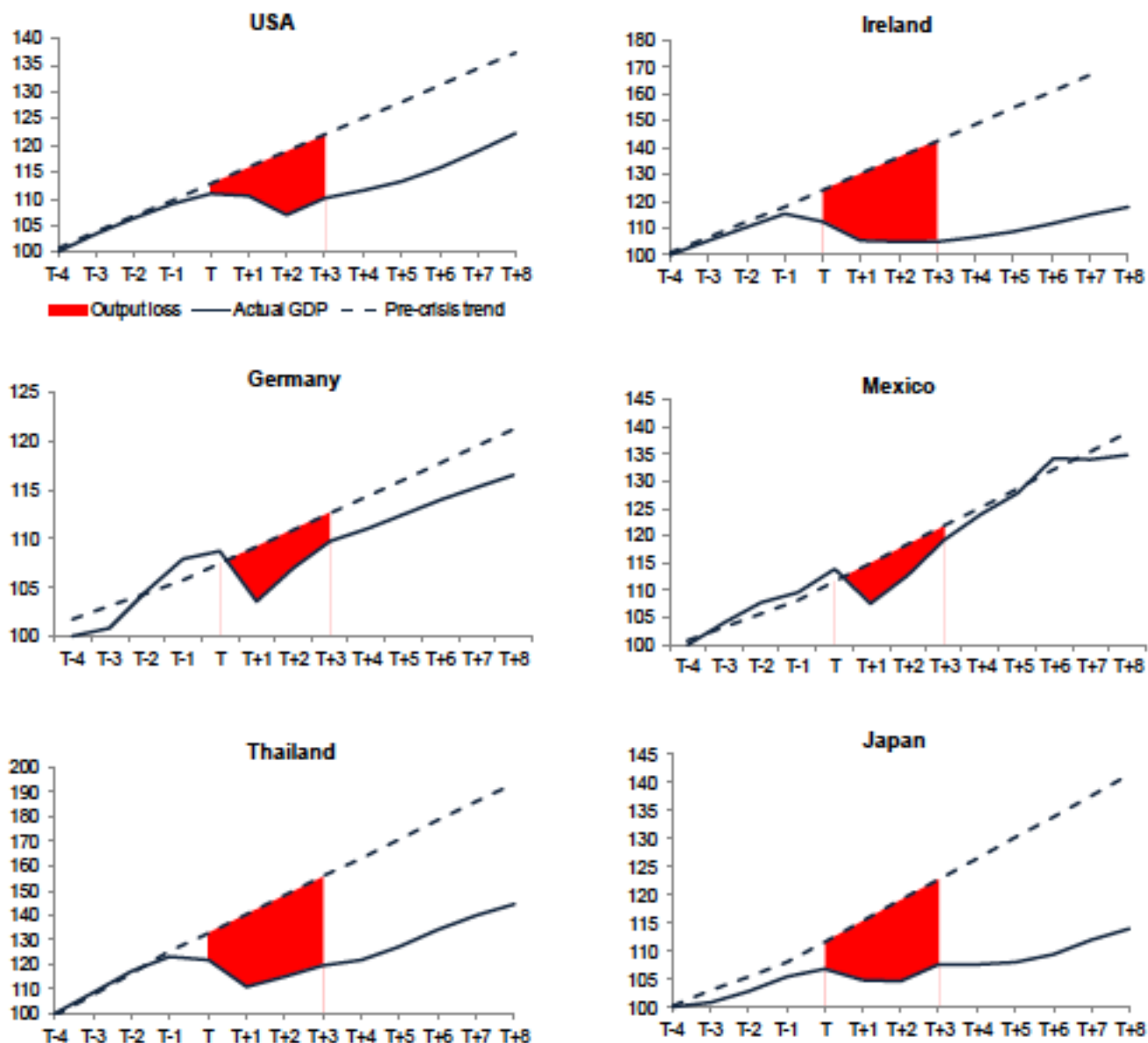




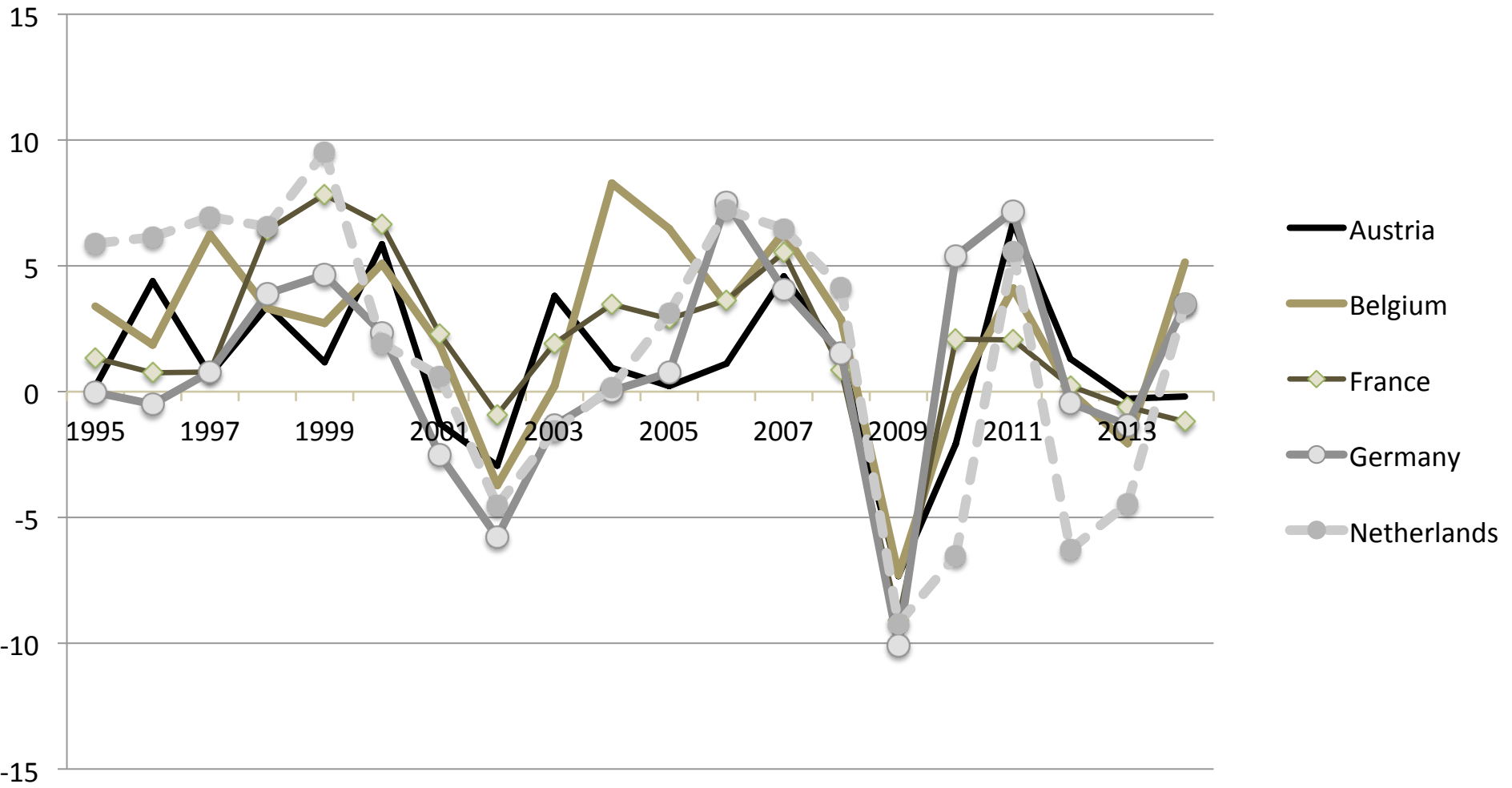
Figure 7. Output Losses for Selected Crises Episodes 1/



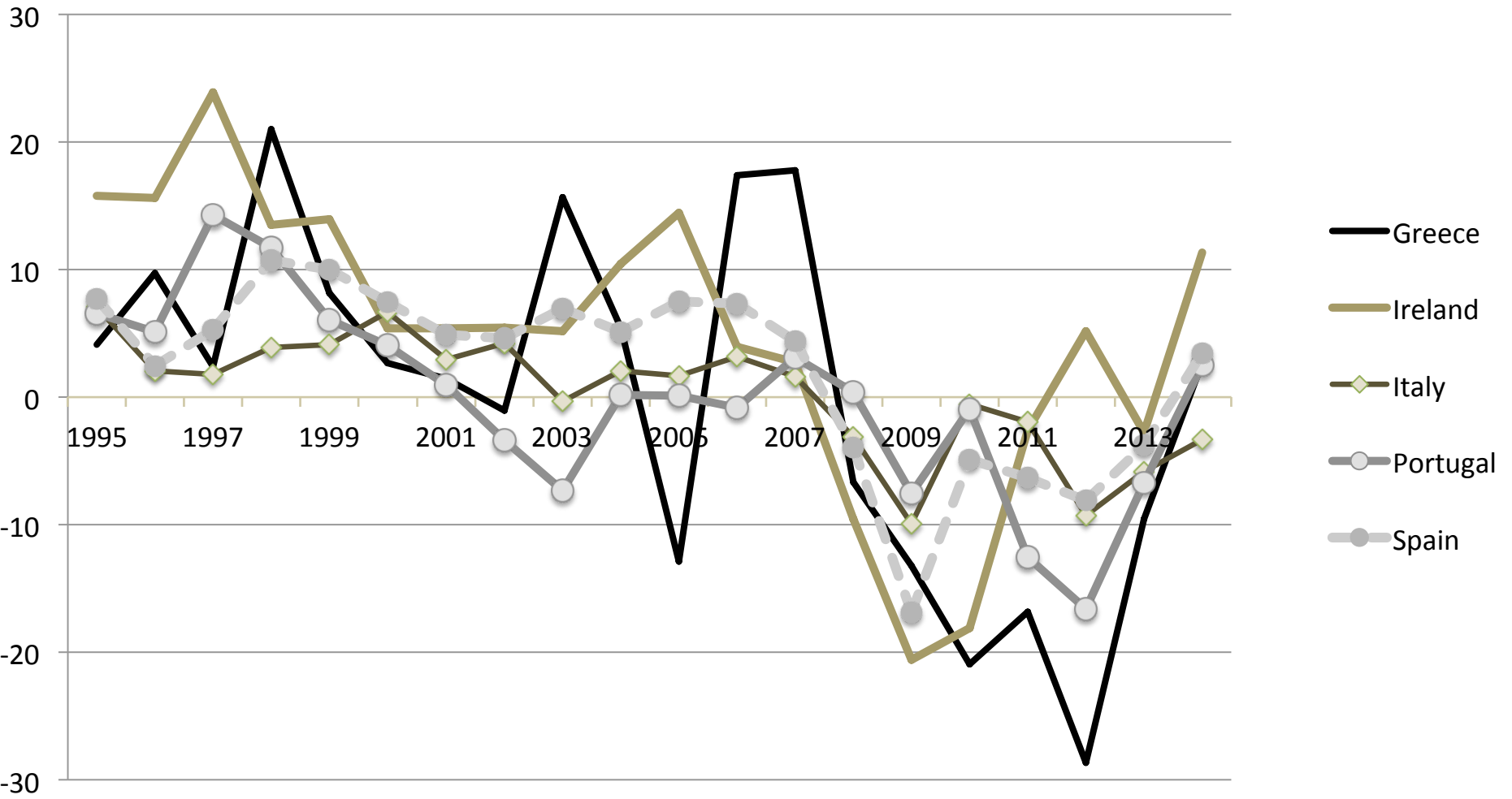
Sources: World Economic Outlook and authors' calculations.

1/Year T equals 2007 for USA, 2008 for Ireland and Germany, 1994 for Mexico, 1997 for Thailand and Japan. GDP in T-4 is set equal to 100.

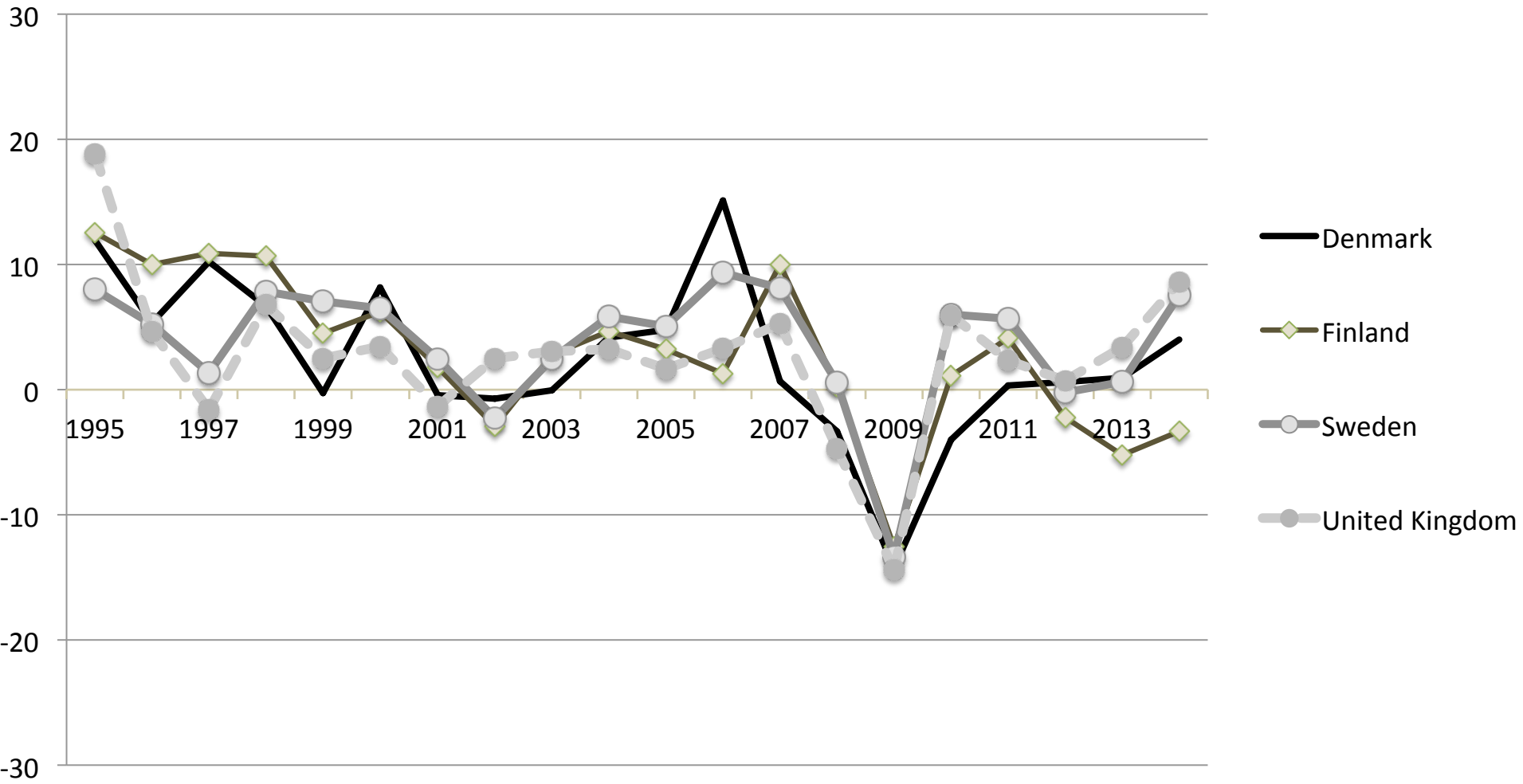
% Growth in Investment (Gross Fixed Capital Formation),  
annual data, 1995-2015, North-central EMU Nations



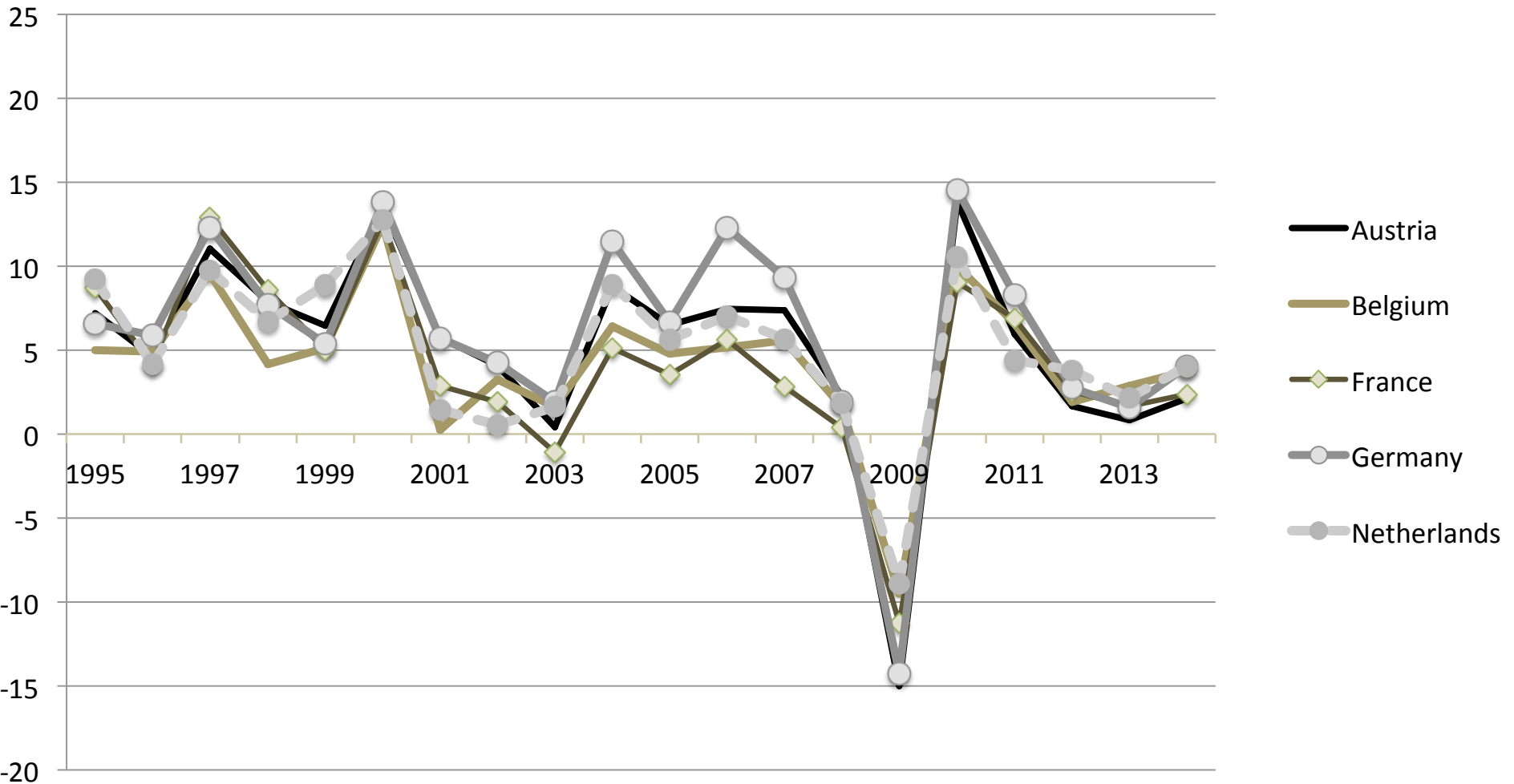
% Growth in Investment (Gross Fixed Capital Formation),  
annual data, 1995-2015, GIPSI EMU Nations



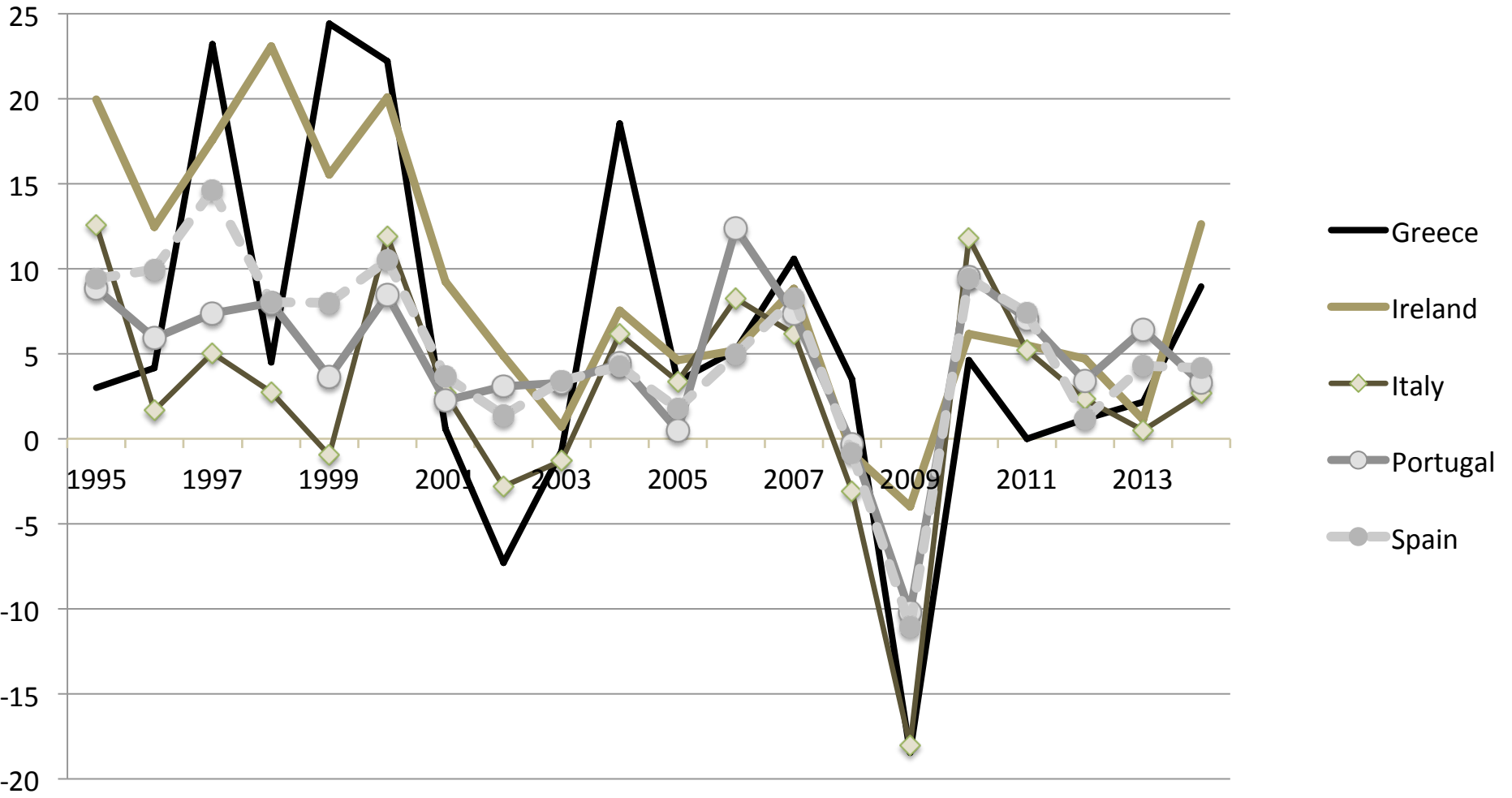
% Growth in Investment (Gross Fixed Capital Formation),  
annual data, 1995-2015, Northern EU Nations



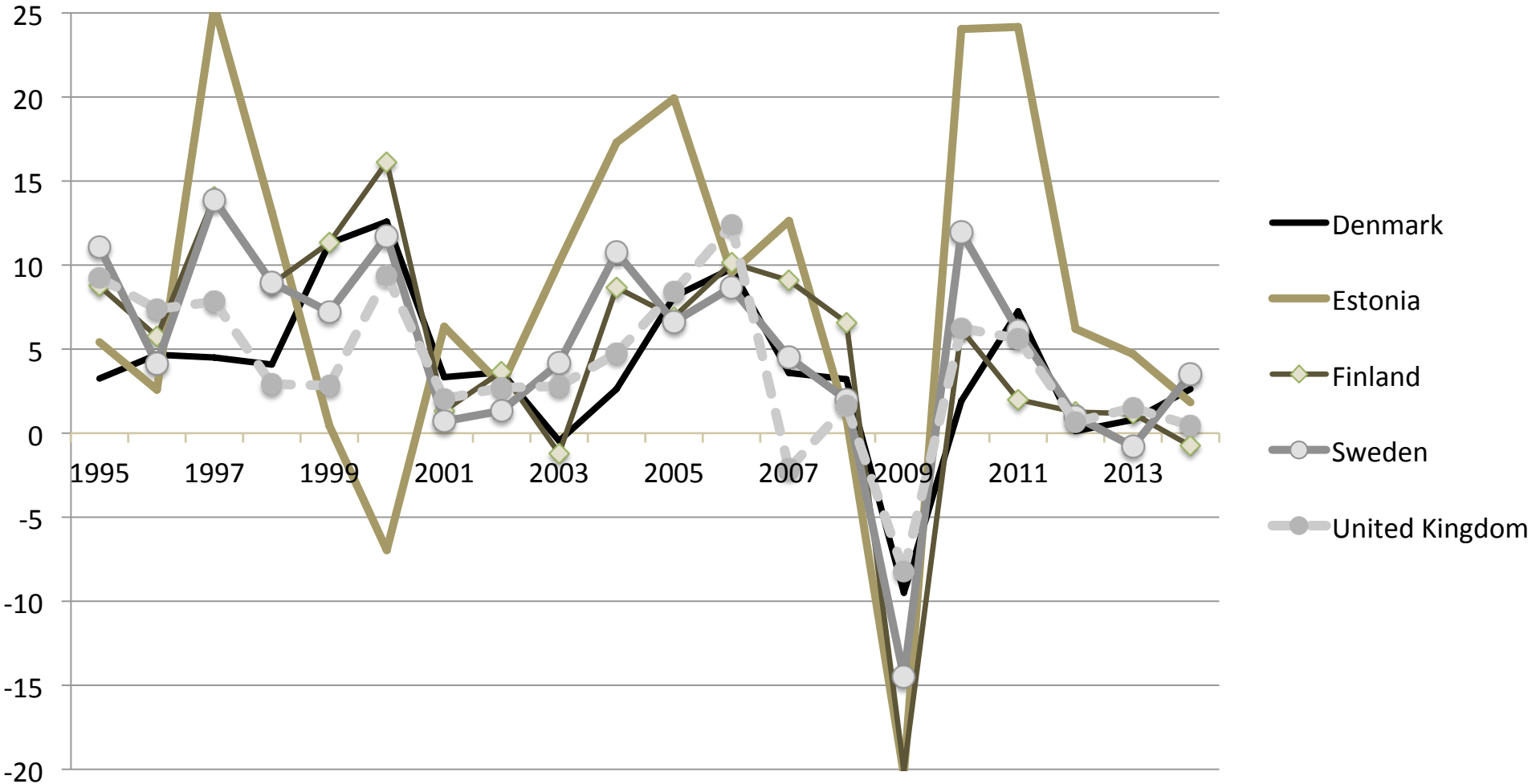
% Growth in Export of Goods and Services, annual data, 1995-2014  
North-central EMU Nations



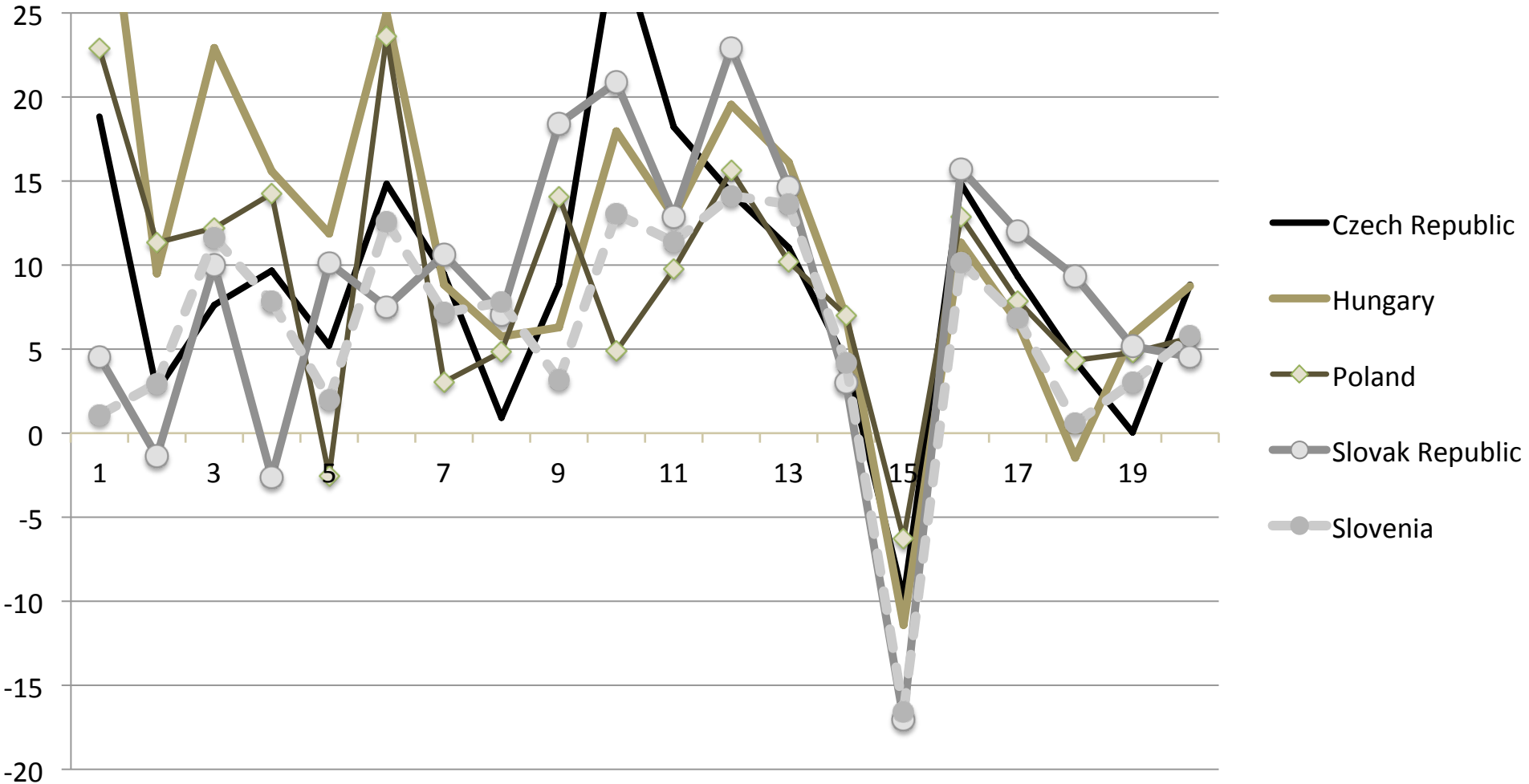
% Growth in Export of Goods and Services, annual data, 1995-2014  
GIPSI EMU Nations



% Growth in Export of Goods and Services, annual data, 1995-2014  
Northern EU Nations



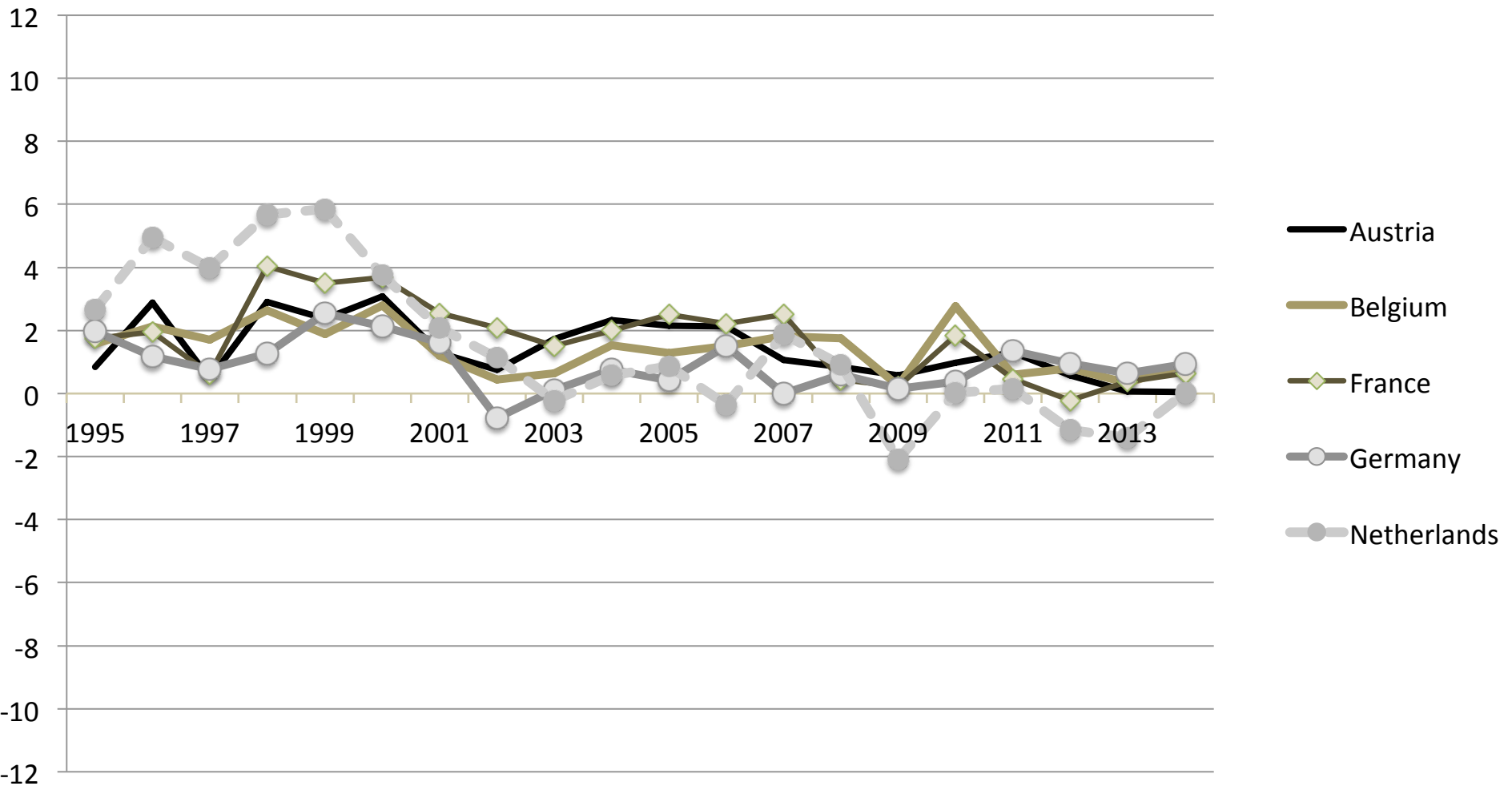
% Growth in Export of Goods and Services, annual data, 1995-2014  
Central-Southern EU Nations



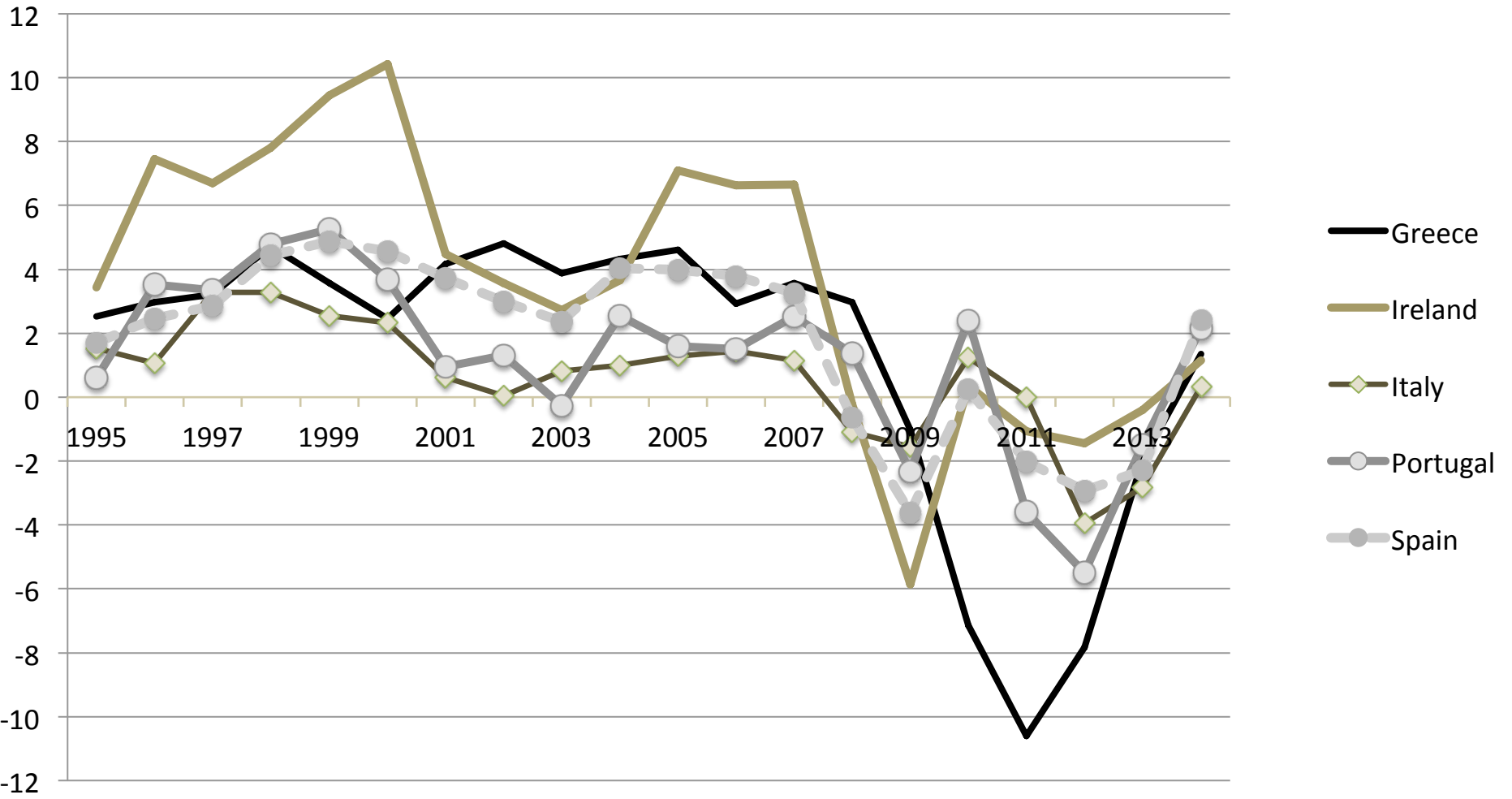


# % Growth in Consumer Expenditures, annual data, 1995-2014

## North-central EMU Nations

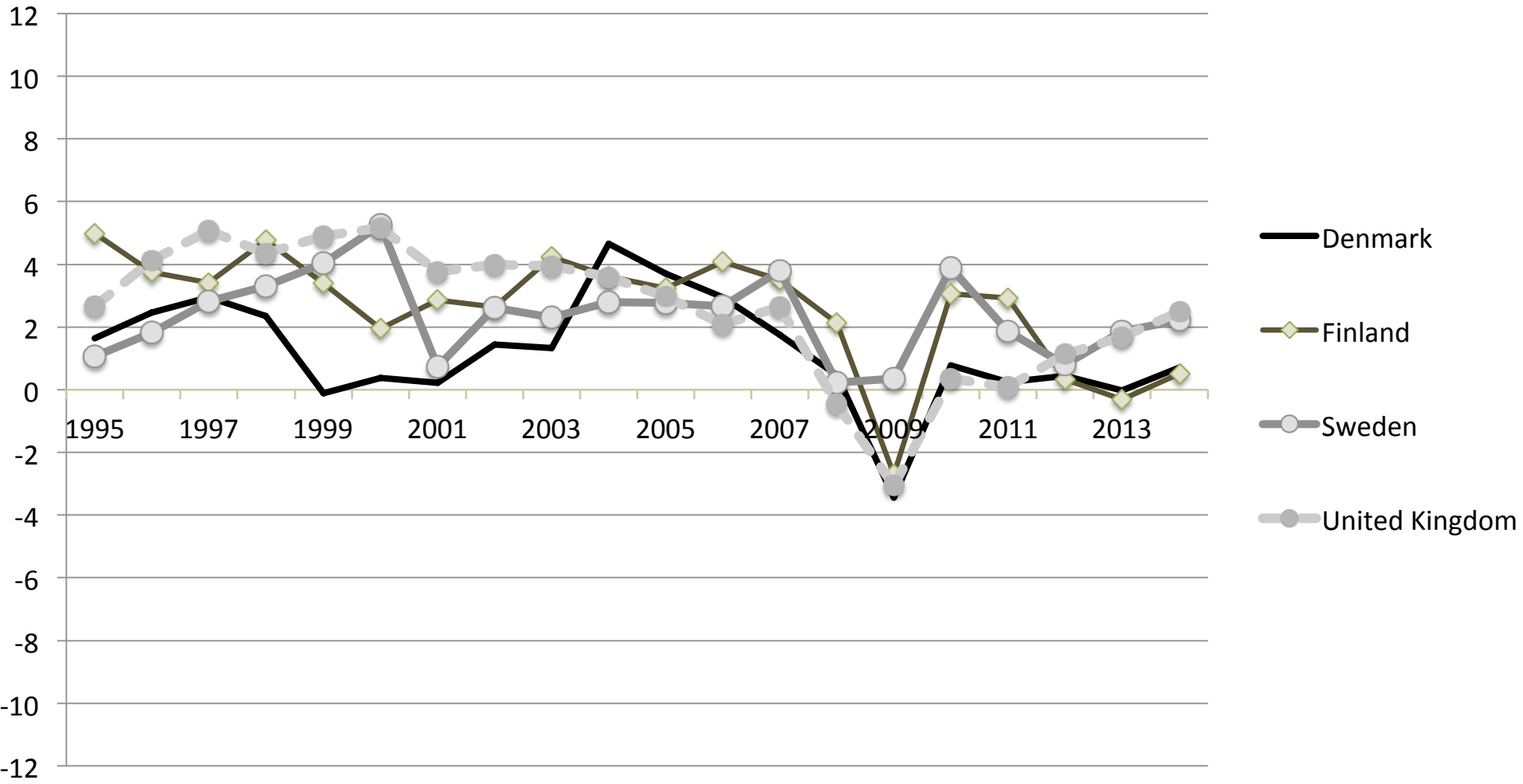


% Growth in Consumer Expenditures, annual data, 1995-2014  
GIPSI EMU Nations

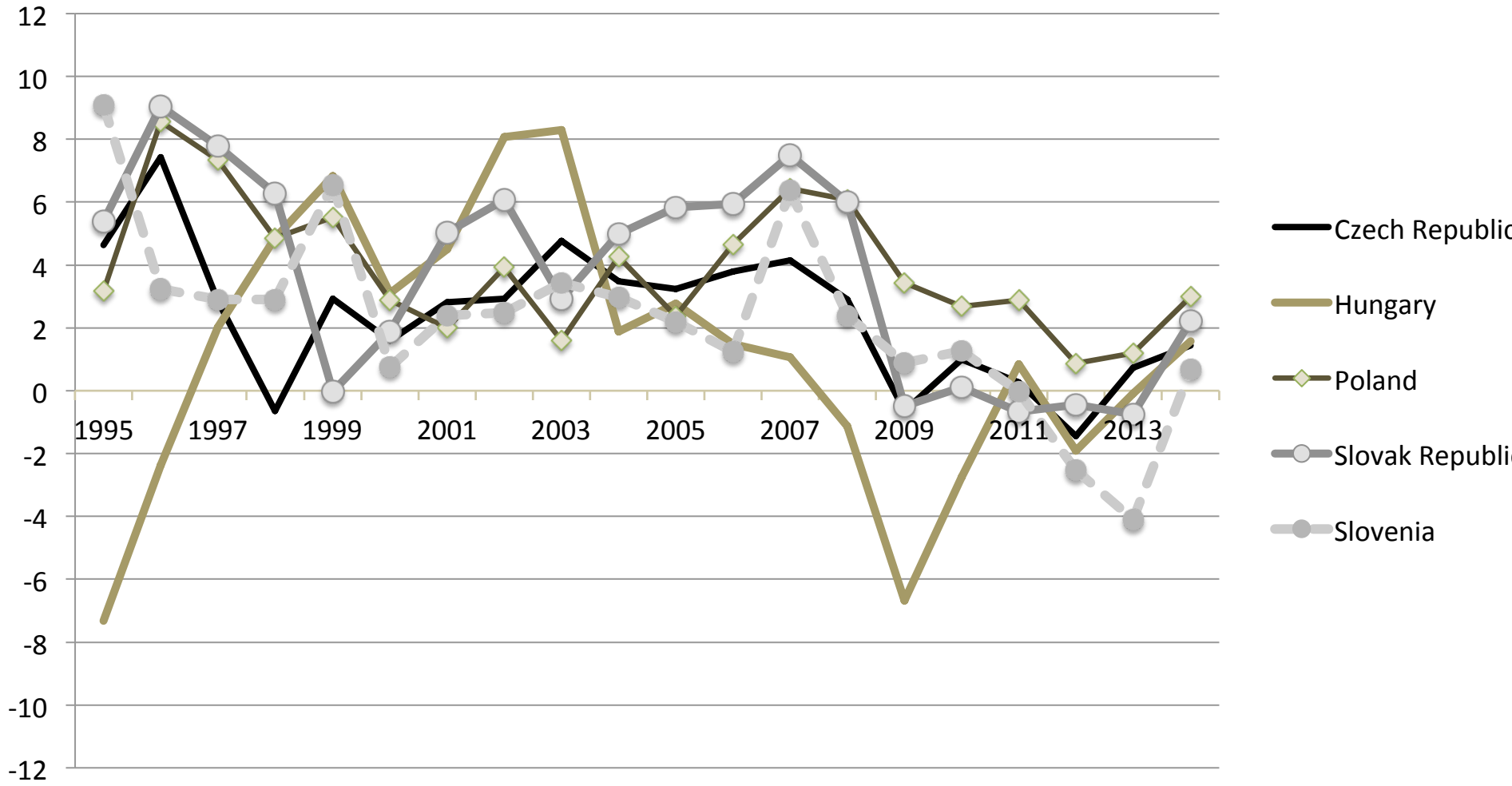


# % Growth in Consumer Expenditures, annual data, 1995-2014

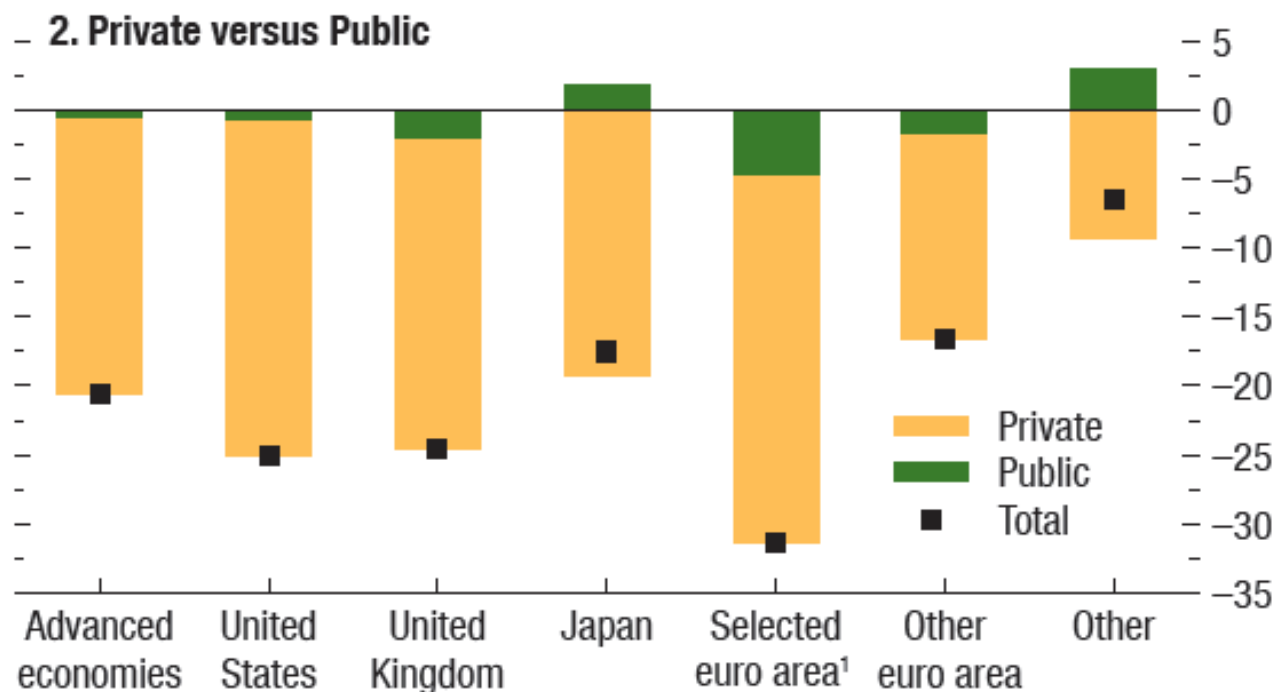
## Northern EU Nations



% Growth in Consumer Expenditures, annual data, 1995-2014  
Central-Southern EU Nations



**Figure 4.4. Decomposition of the Investment Slump, 2008–14**  
*(Average percent deviation from spring 2007 forecasts)*



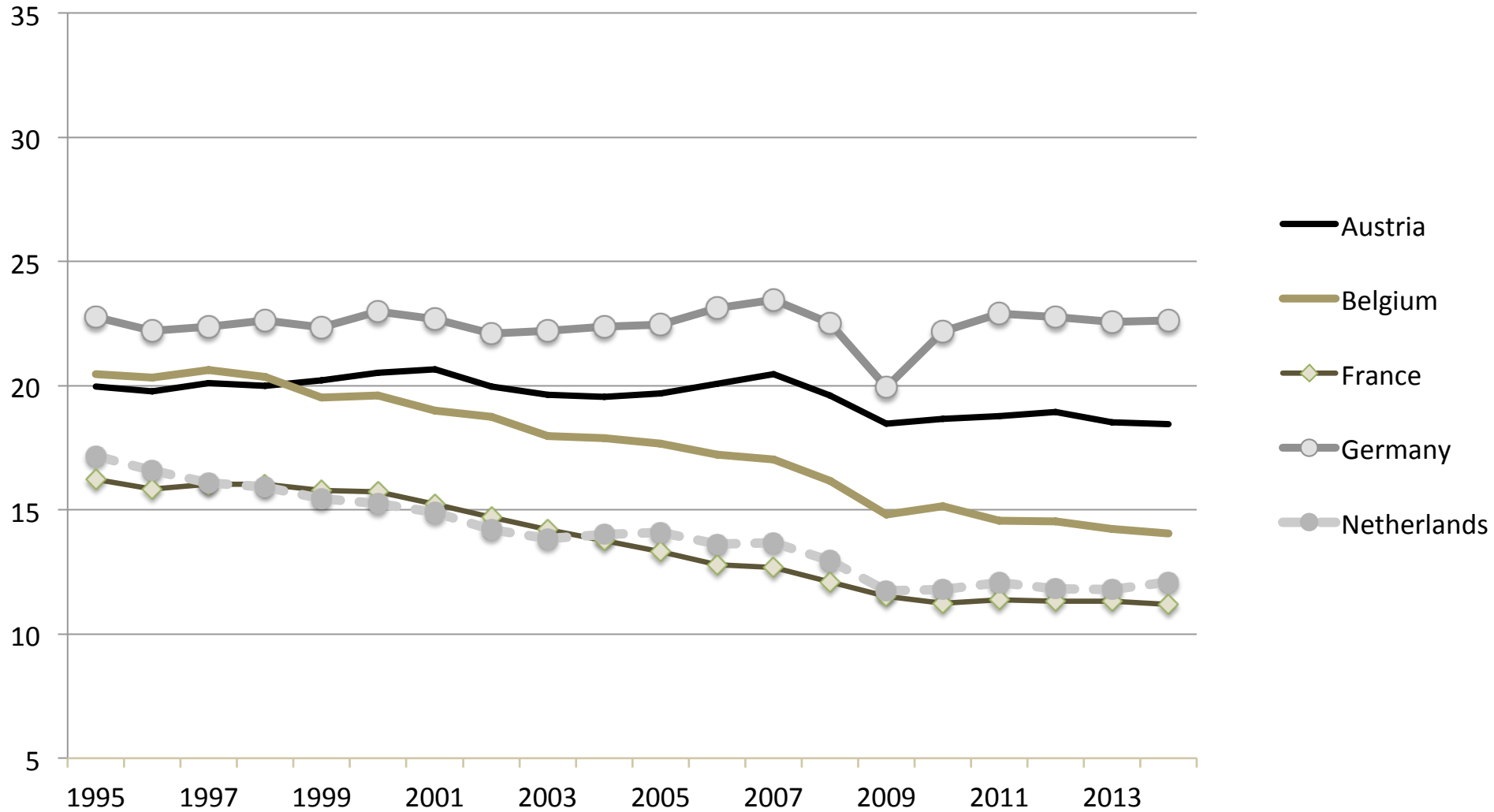
Sources: Consensus Economics; Haver Analytics; IMF, Fiscal Monitor database; national authorities; and IMF staff estimates.

Note: The figure presents data for 28 advanced economies: Australia, Austria, Canada, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Israel, Italy, Japan, Korea, Latvia, Luxembourg, Malta, Netherlands, New Zealand, Norway, Portugal, Singapore, Slovak Republic, Slovenia, Spain, Sweden, United Kingdom, United States.

<sup>1</sup>Euro area economies (Greece, Ireland, Italy, Portugal, Spain) with high borrowing spreads during the 2010–11 sovereign debt crisis.

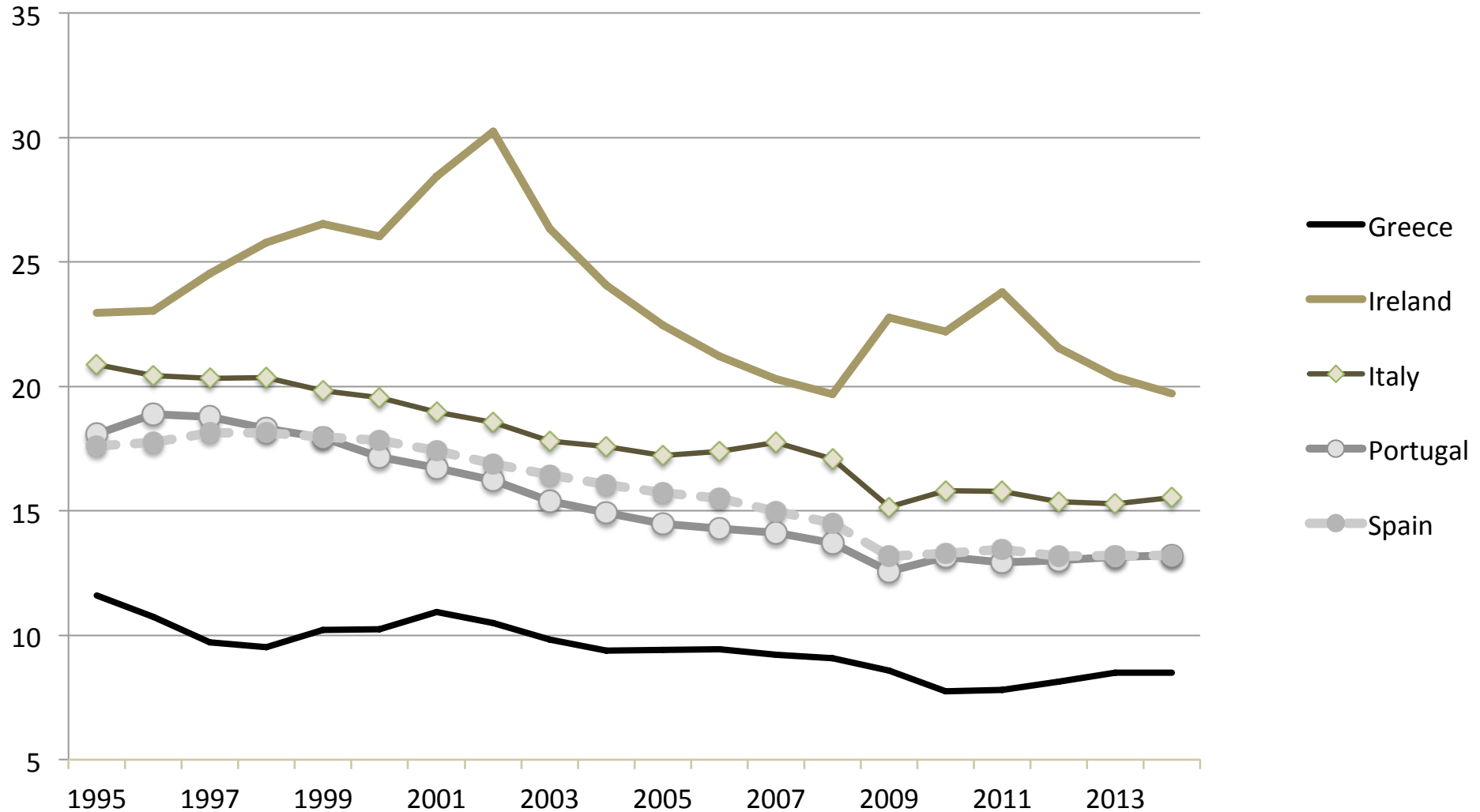
# Manufacturing as share of value added, annual data, 1995-2014

## North-central EMU Nations



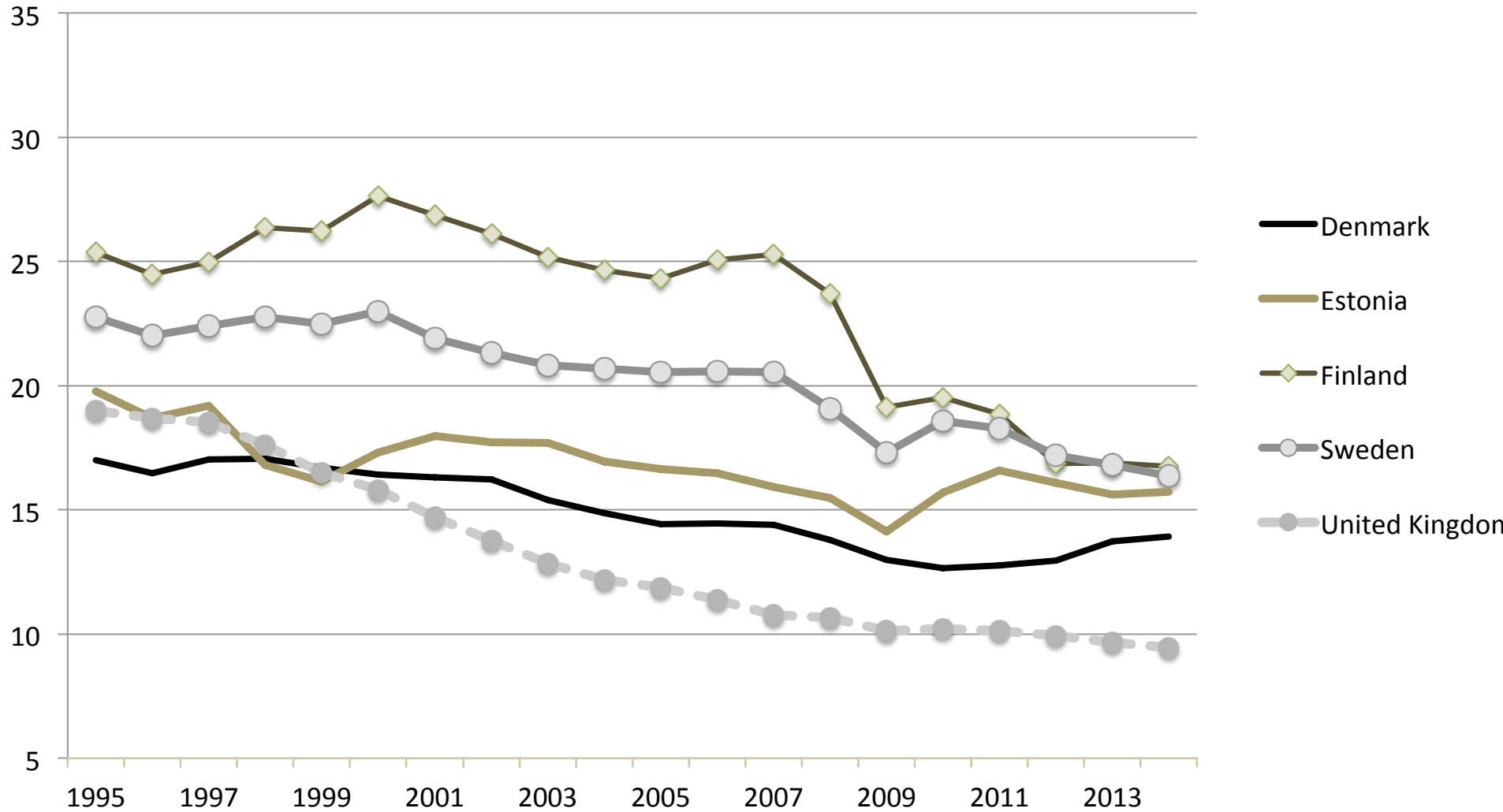
# Manufacturing as share of value added, annual data, 1995-2014

## GIPSI EMU Nations



# Manufacturing as share of value added, annual data, 1995-2014

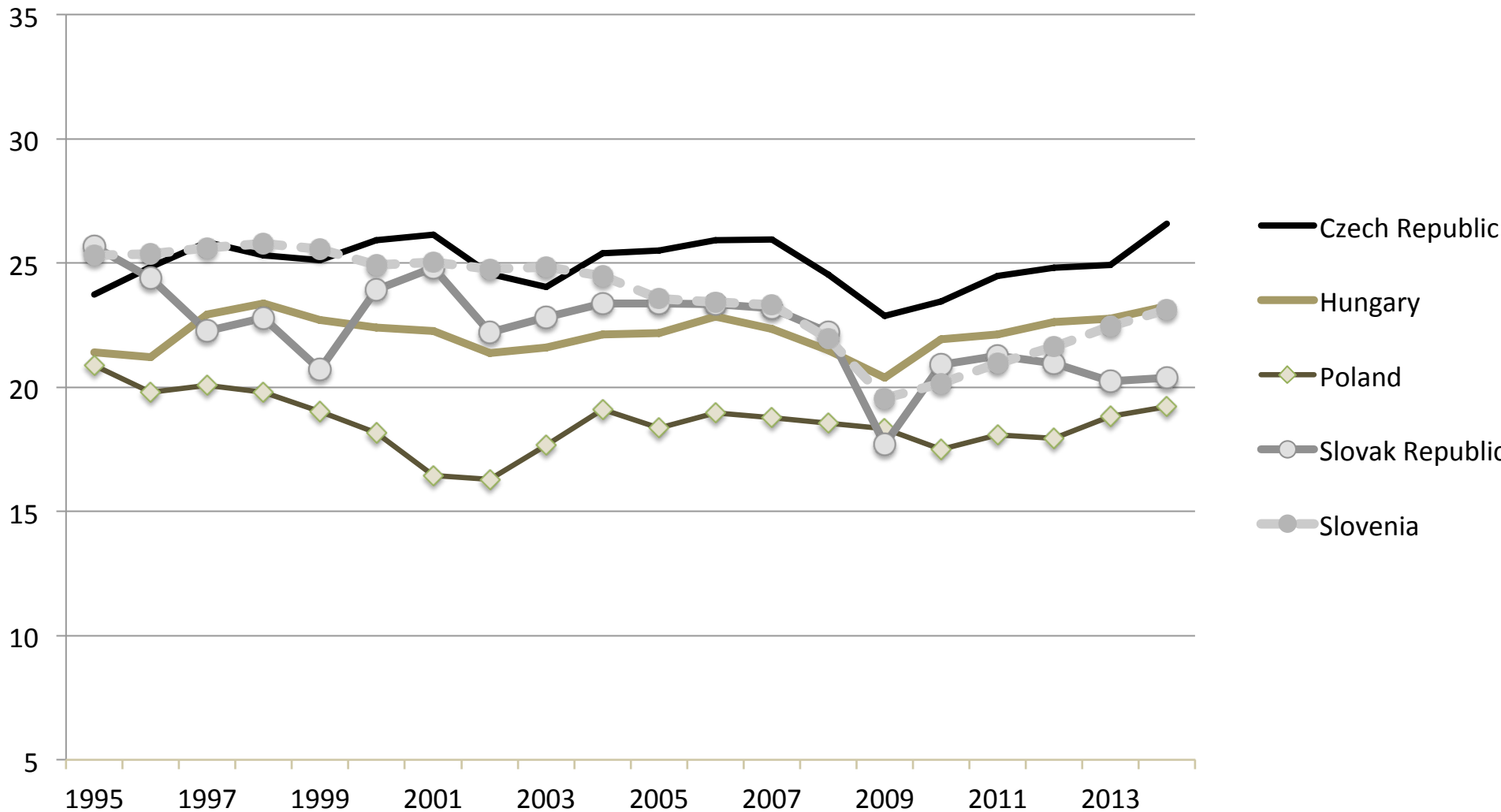
## Northern EU Nations



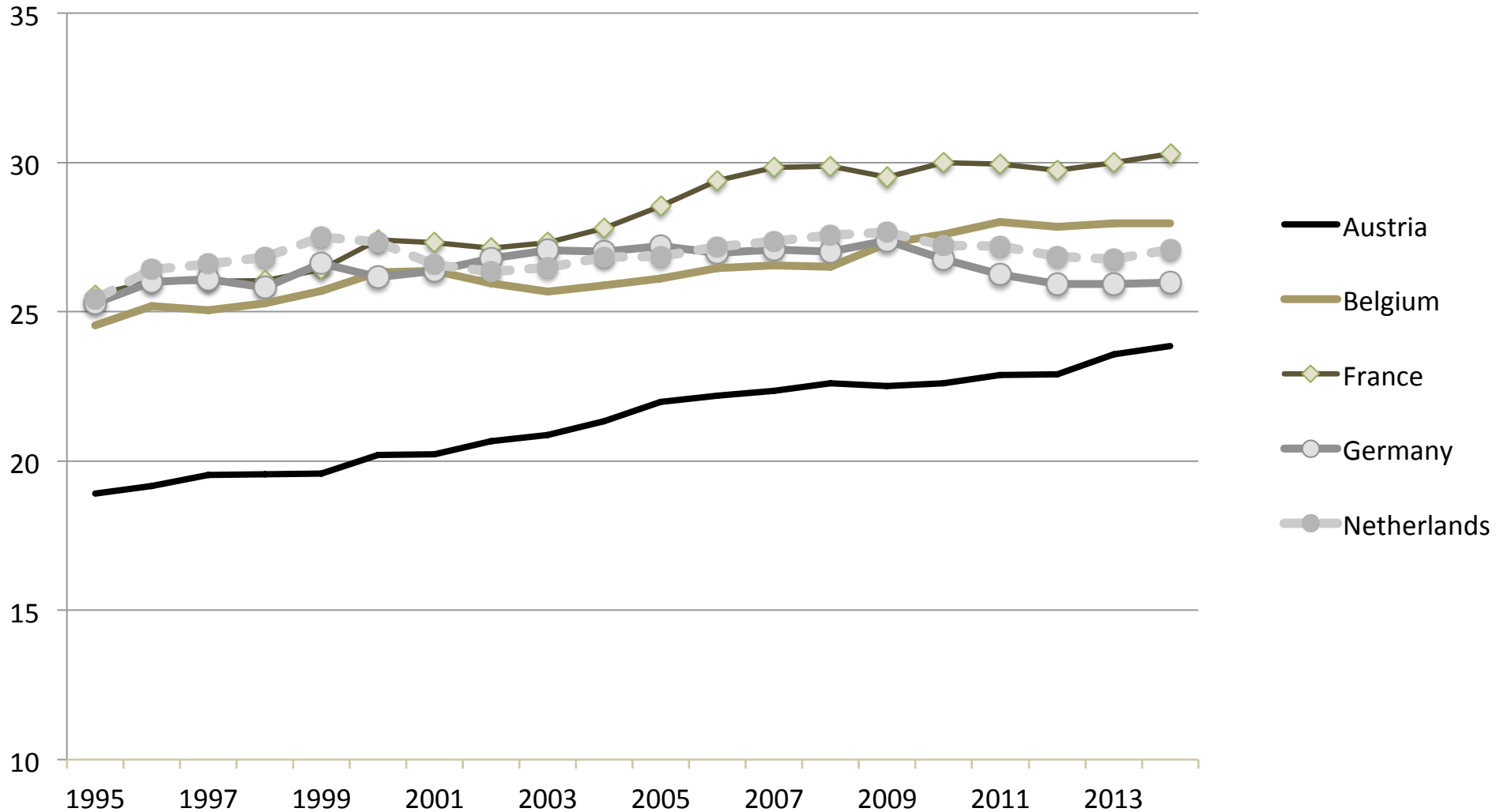


# Manufacturing as share of value added, annual data, 1995-2014

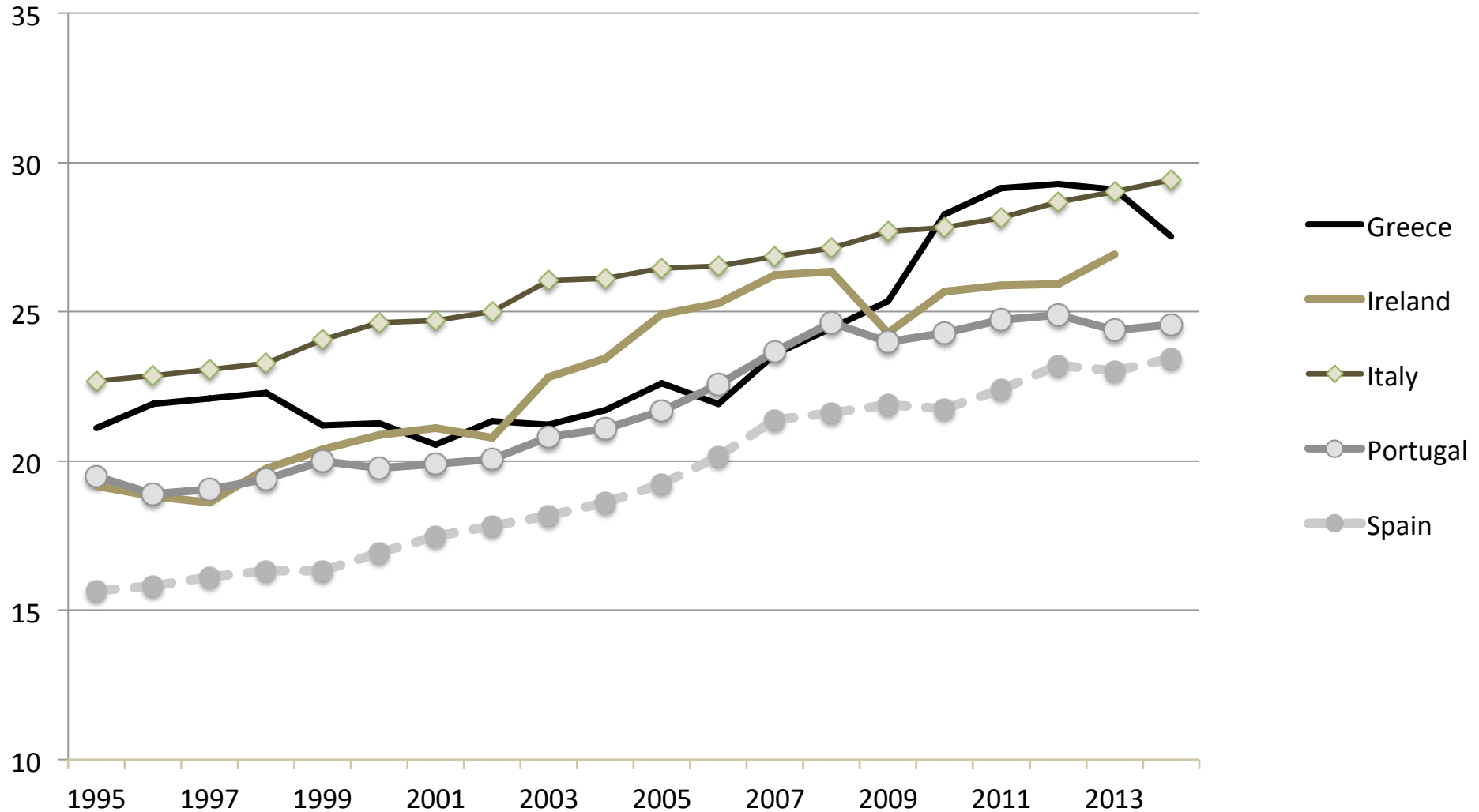
## Central-Southern EU Nations



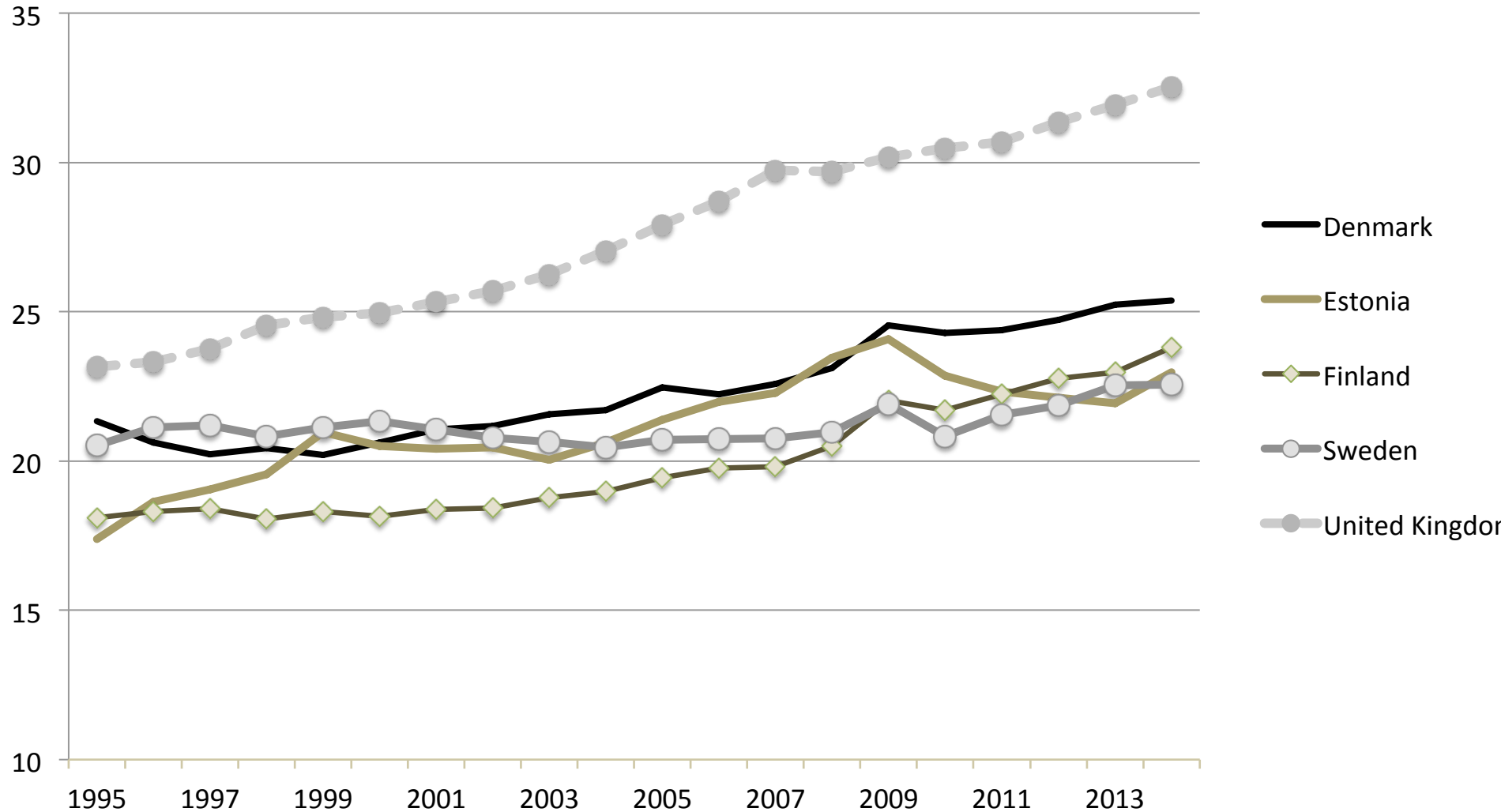
Finance/insurance/real estate (FIRE) as share of value added, annual data, 1995-2014, North-central EMU Nations



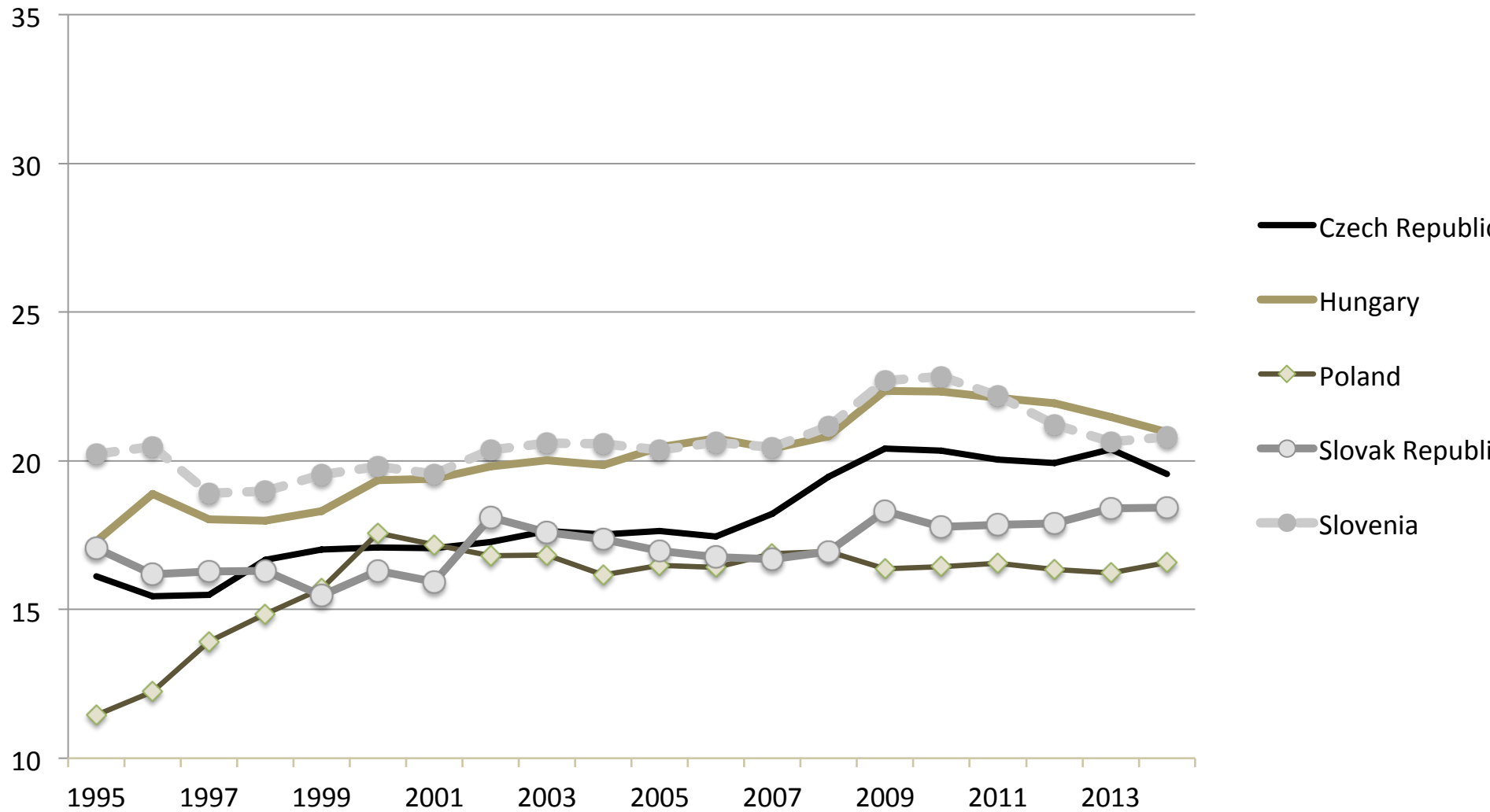
Finance/insurance/real estate (FIRE) as share of value added,  
annual data, 1995-2014, GIPSI EMU Nations



Finance/insurance/real estate (FIRE) as share of value added, annual data, 1995-2014, Northern EU Nations



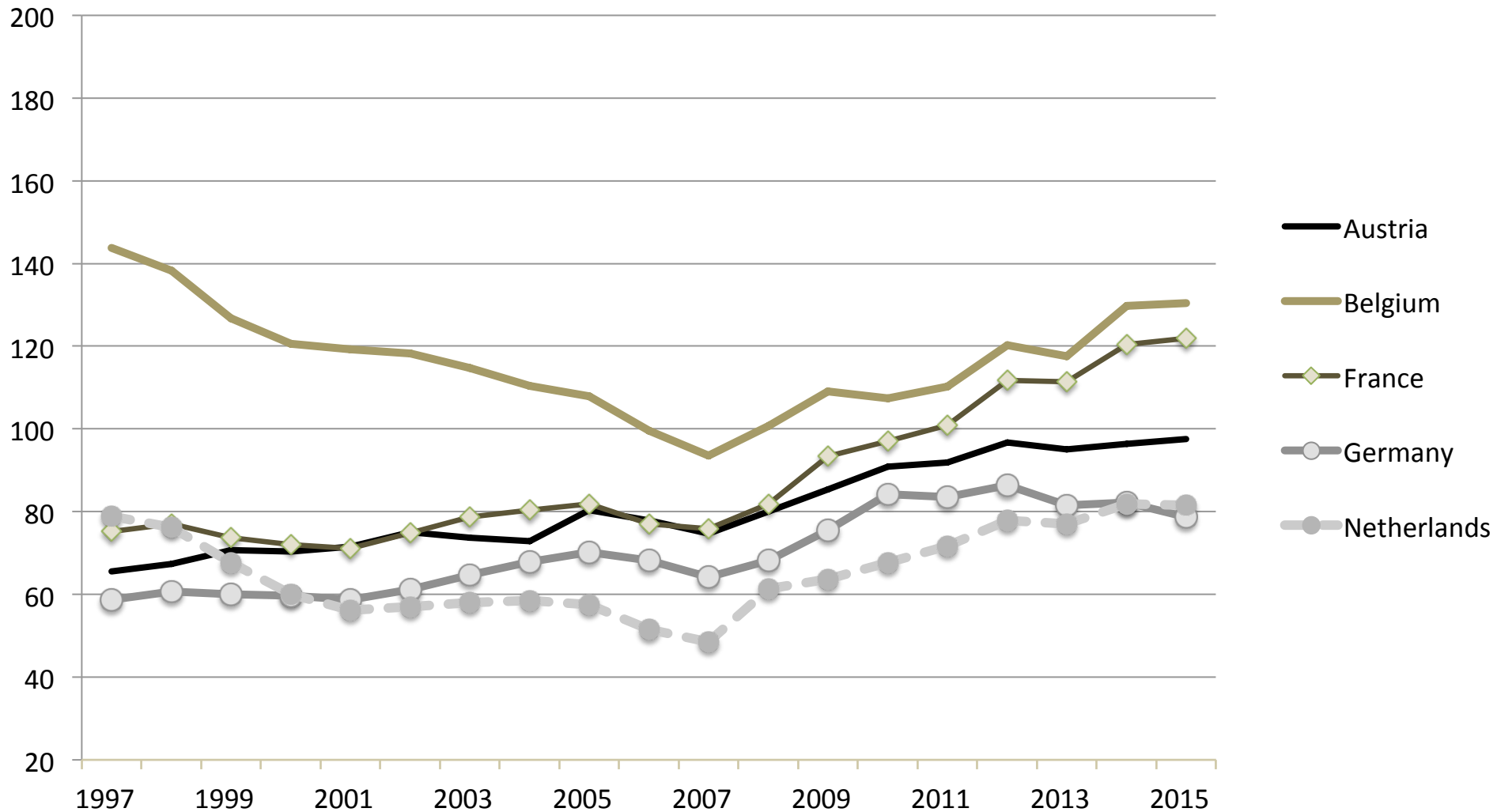
Finance/insurance/real estate (FIRE) as share of value added,  
annual data, 1995-2014, Central-Southern EU Nations



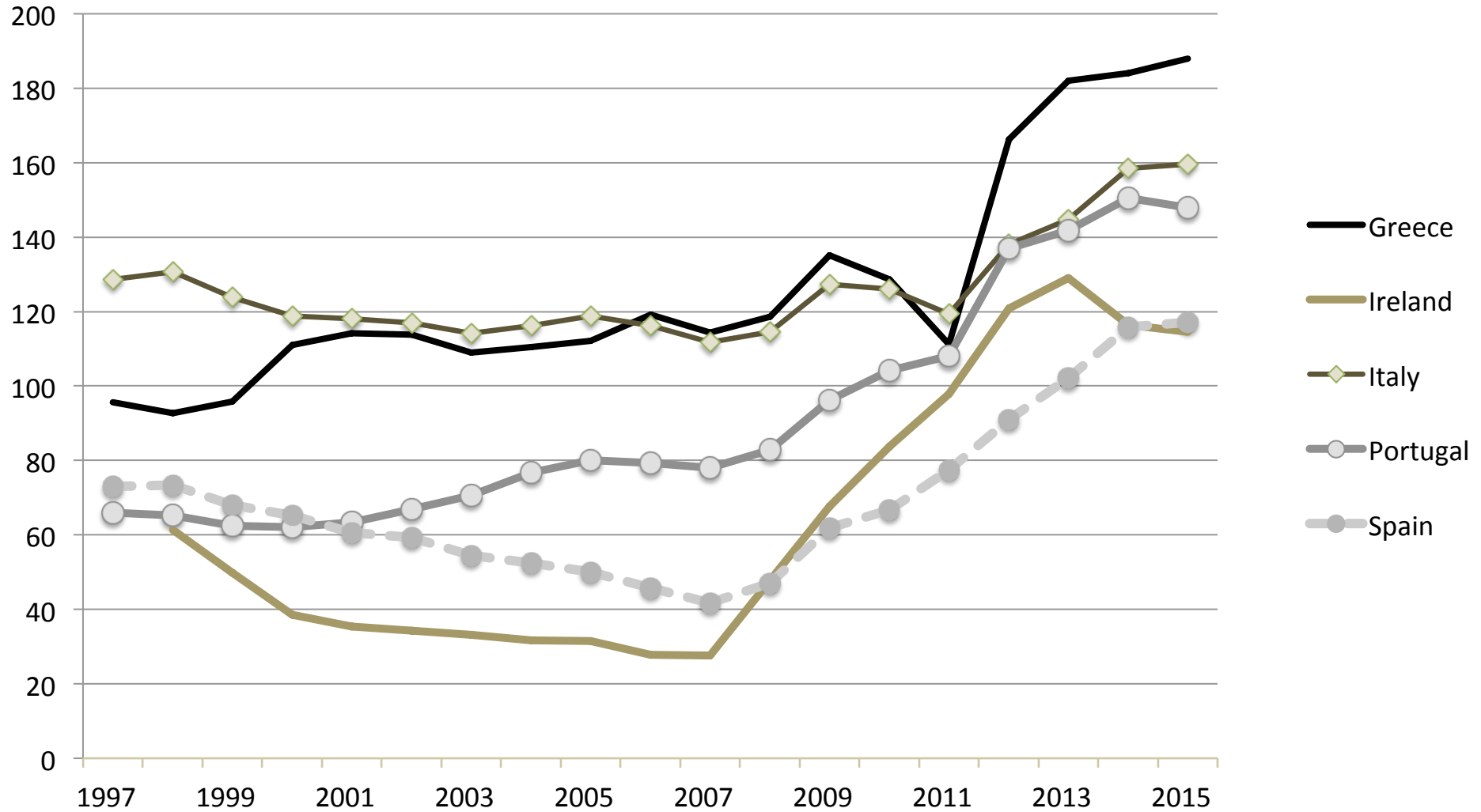
### 3. Recent economic policies: fiscal policy, monetary policy, financial policies

- Fiscal policy: Deepening austerity
- Monetary policy: Quantitative easing by the ECB
- Financial policies: Banking Union, Capital Markets Union

Gross government debt as % of GDP, annual data, 1995-2015,  
Northern EMU Nations

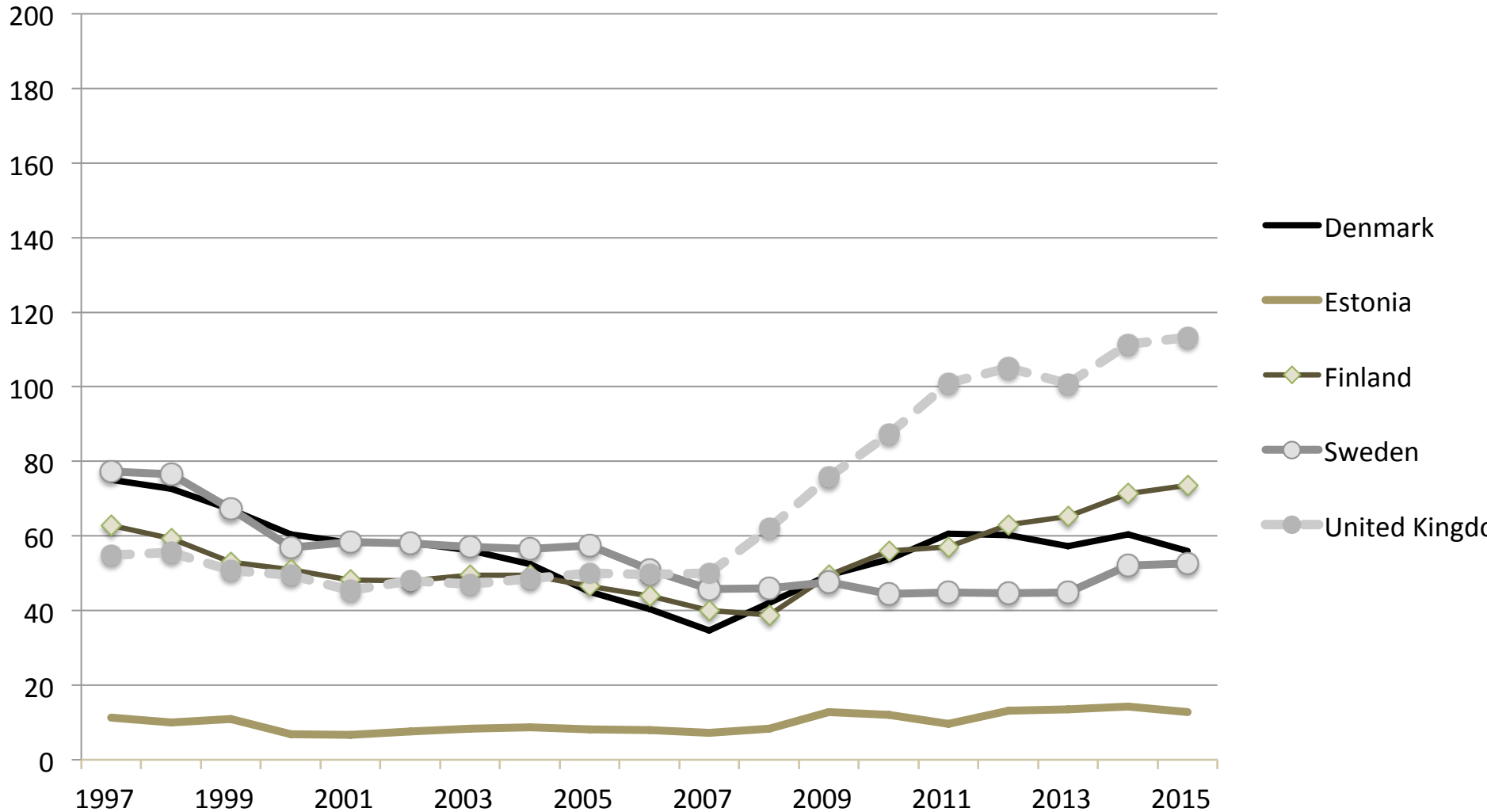


Gross government debt as % of GDP, annual data, 1995-2015,  
GIPSI EMU Nations

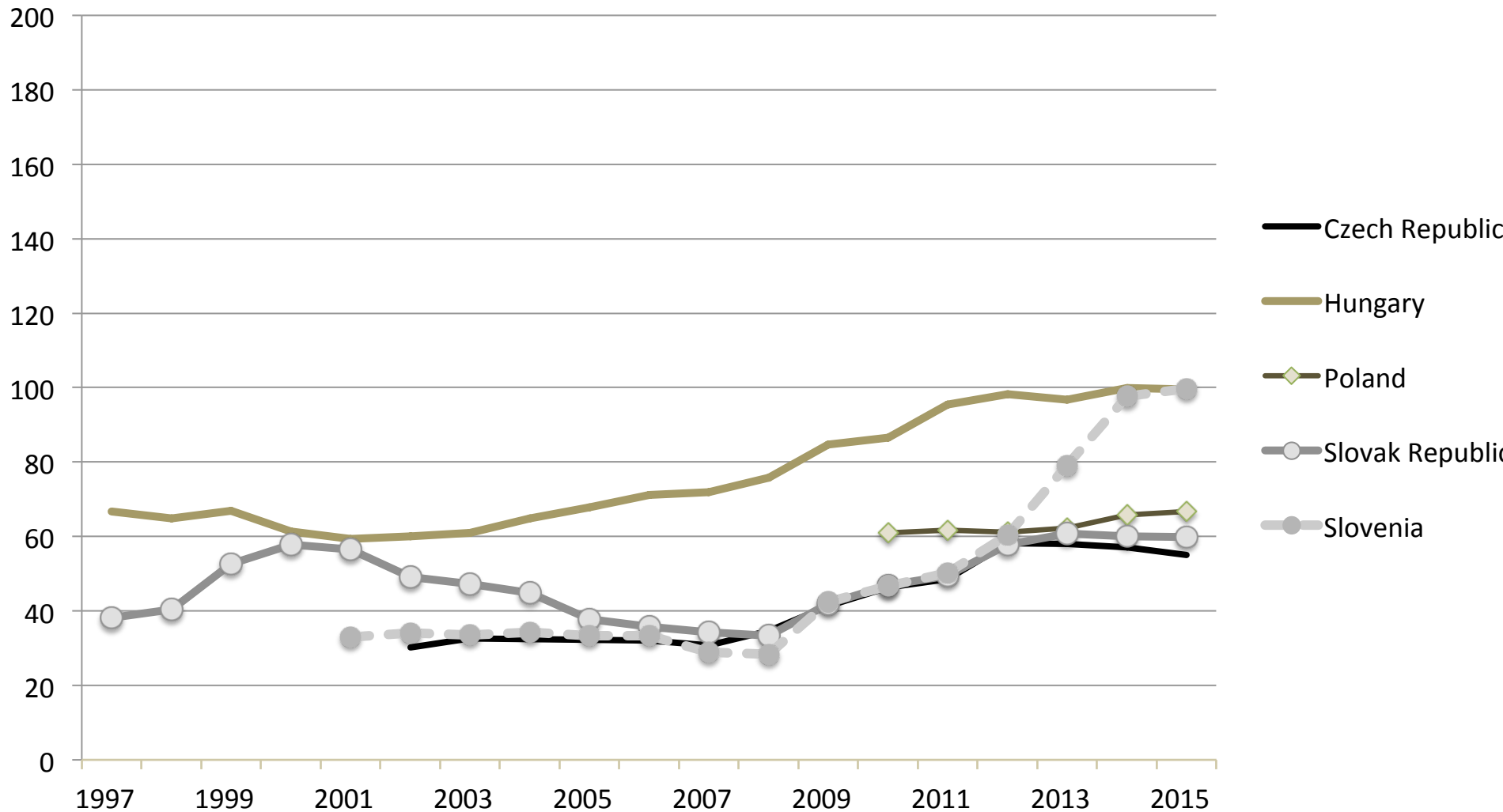




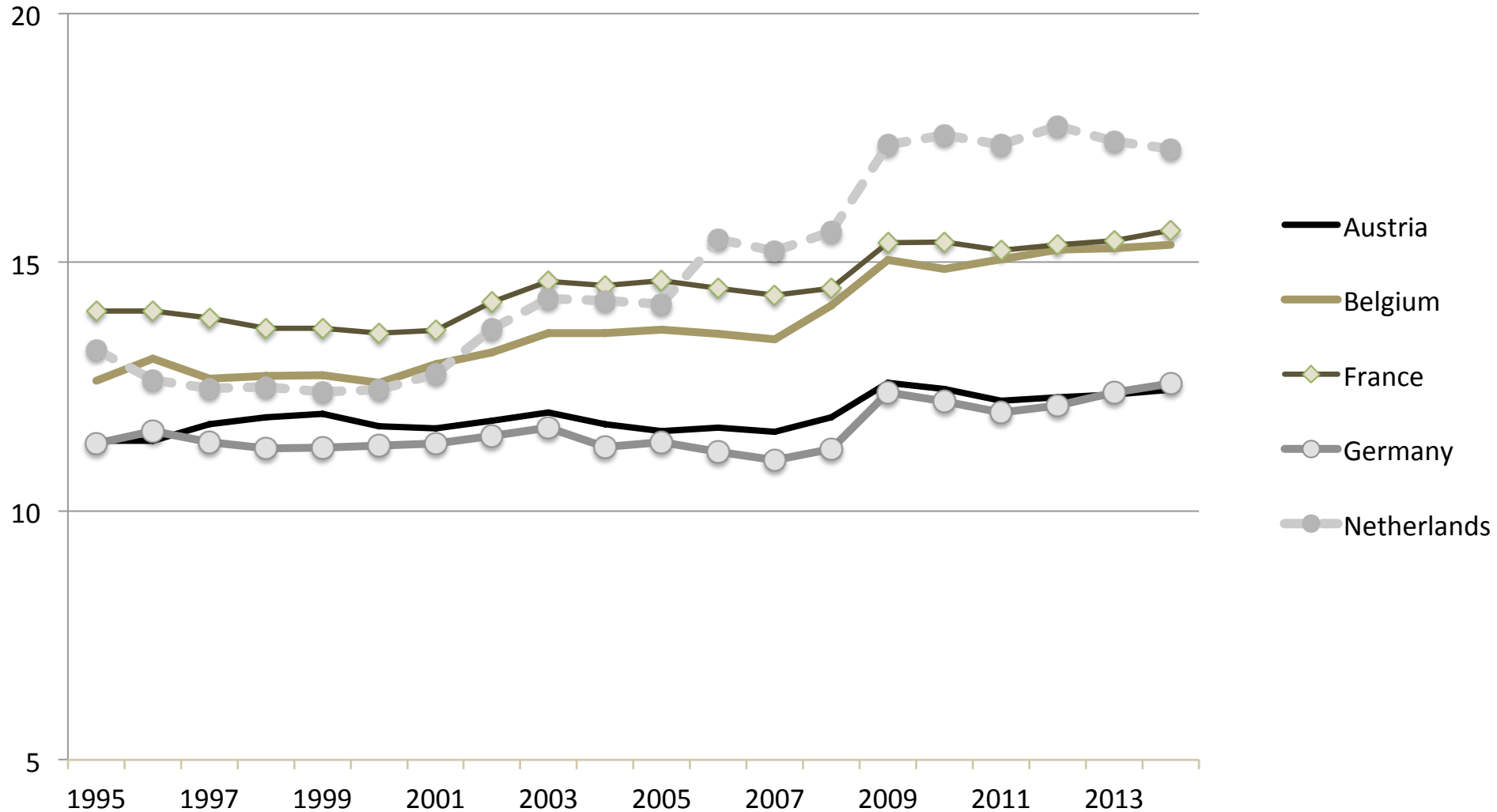
Gross government debt as % of GDP, annual data, 1995-2015,  
Northern EU Nations



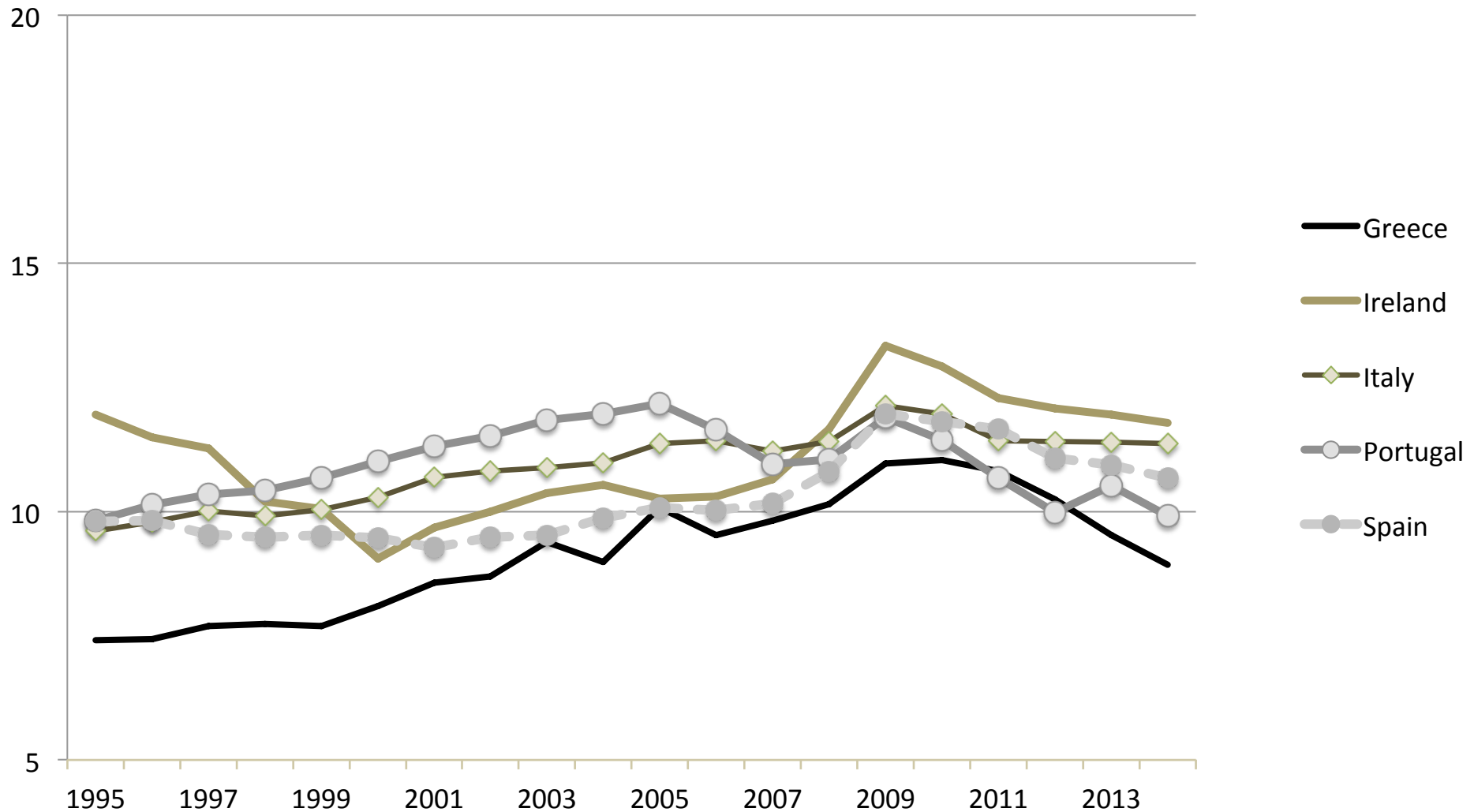
Gross government debt as % of GDP, annual data, 1995-2015,  
Central-Southern EU Nations



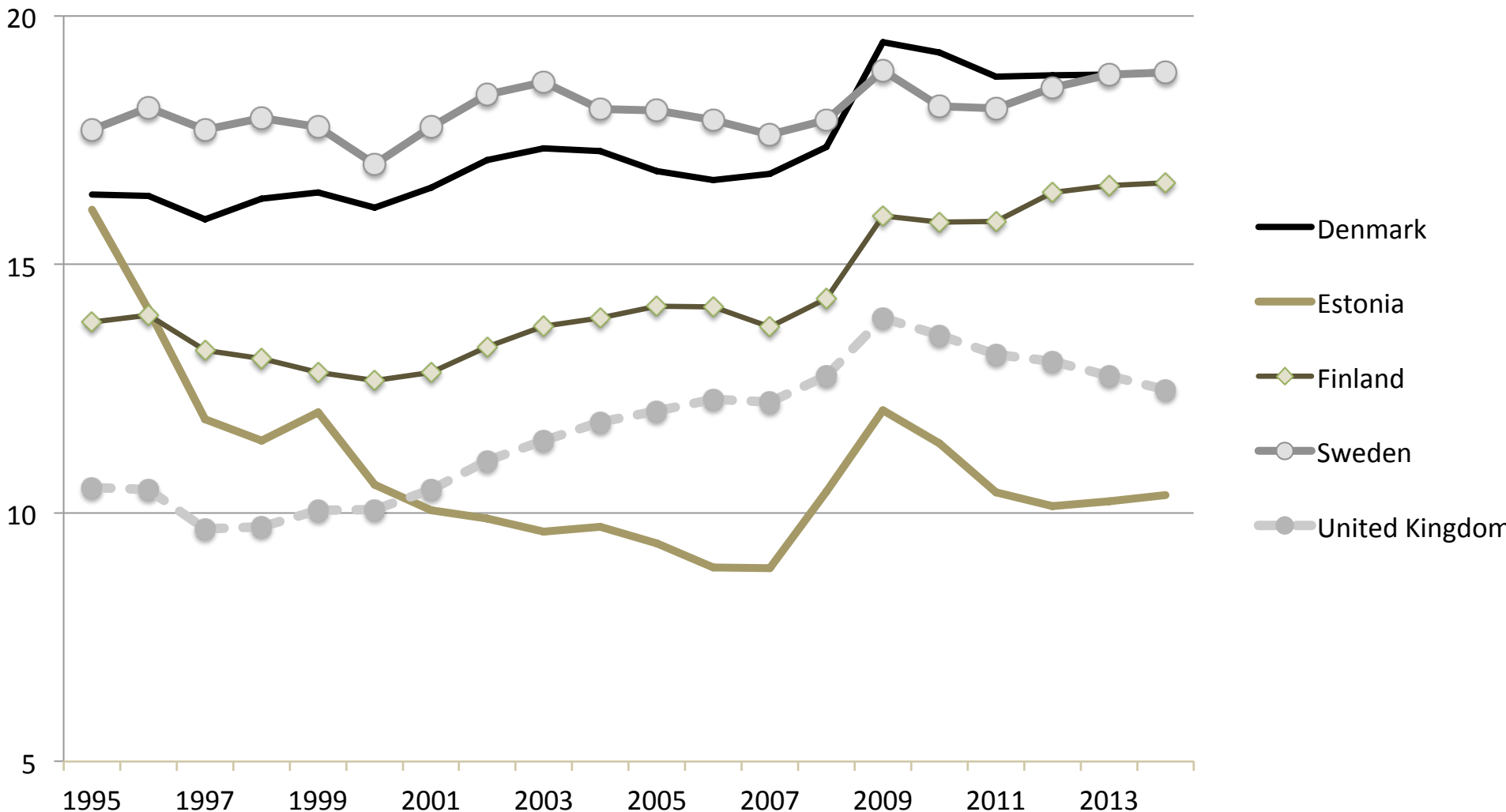
Government spending on individuals as % of GDP, annual data, 1995-2014, North-central EMU Nations



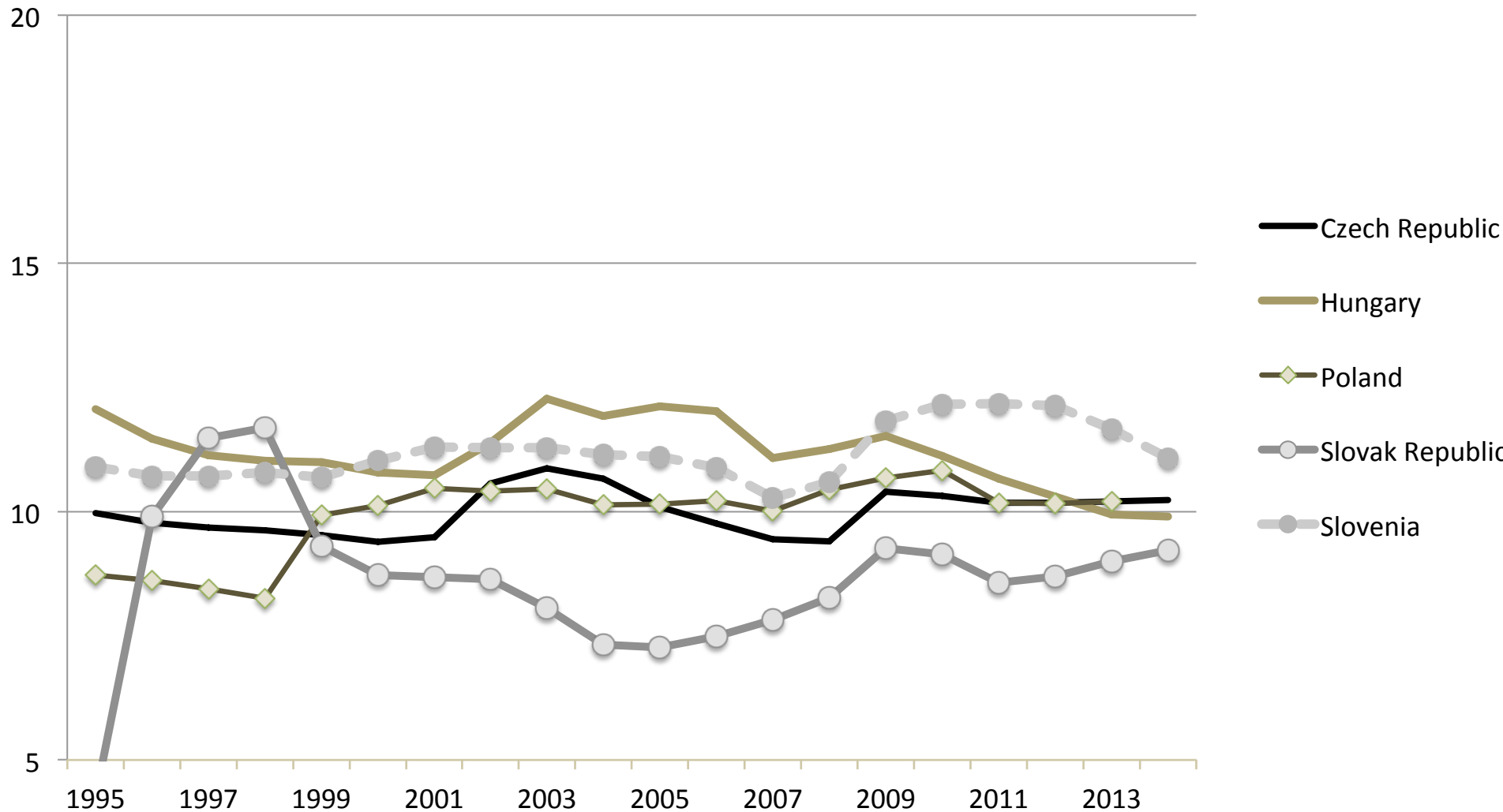
Government spending on individuals as % of GDP, annual data, 1995-2014, GIPSI EMU Nations



Government spending on individuals as % of GDP, annual data, 1995-2014, Northern EU Nations



Government spending on individuals as % of GDP, annual data, 1995-2014, Central-Southern EU Nations



# Two arguments for austerity macro policy in the developed economies

*1. Is there a 90% threshold for sovereign debt/income?*

Barry Eichengreen, *Hall of Mirrors* (2015), p. 10:

- No. Especially when borrowing is cheap and there are underemployed resources.

*2. Is there evidence that austerity has expansionary macro effects?*

Eichengreen, 2015, p. 10:

- No. The cases referred to in academic work are special cases, whose conditions are not now replicated.

# New arguments for expansionary fiscal policy in the developed economies

*1. Does expansionary fiscal policy have a multiplier greater than 1?*

IMF (Cottarelli, Gerson, Sanhadji, *Post-Crisis Fiscal Policy*, 2015)

- Under two conditions: (a) a very deep recession, such as the US or UK experienced in 2008-09; (b) in a mild recession or under stagnation, only if there is coordinated multilateral expansionary policy.

*2. Can monetary policy do it all (stimulate growth, avoid inflationary pressure)?*

Claudio Borio (BIS), Richard Fisher (Federal Reserve)

- No.





EUROPEAN CENTRAL BANK  
EUROSYSTEM

## Occasional Paper Series

Thomas Warmedinger,  
Cristina Checherita-Westphal  
and Pablo Hernández de Cos

Fiscal multipliers and beyond

The primary objective of this paper is twofold: first, to present a critical assessment of the most recent findings of the literature on state-dependent short-term fiscal multipliers and, second, to go beyond the multiplier discussion and address the topic of potentially self-defeating fiscal consolidation from the perspective of debt sustainability.

The literature review reconfirms that there is considerable uncertainty surrounding the size of fiscal multipliers. As such, there is no "single" short-term fiscal multiplier: multipliers may be larger in times of deep recession or financial crises, but they tend to be smaller when fiscal positions are precarious.

When determining the fiscal adjustment path, both the short-term costs and the longer-term benefits need to be taken into account. It is also advisable to conduct a specific analysis of the macroeconomic situation of the country under scrutiny. In many cases, avoiding the short-term costs of fiscal consolidations is not a viable option. Countries that are under fiscal stress are forced to frontload fiscal consolidation in order to meet financing needs and rapidly restore fiscal soundness to avoid abruptly negative market reactions. This could be particularly relevant at the start of the consolidation process or at any moment where credibility is lost or at risk. A more gradual consolidation could then only be considered after credibility has been fully restored. In addition, when defining the path for fiscal consolidation,

# Quantitative easing: ambivalent embrace

July 20, 2015 5:52 pm

## QE feeding Europe house price bubble, says study

The European Central Bank's quantitative easing programme risks fuelling house price bubbles in several countries, according to new research, as investors pour cash into real estate.

Germany, Norway and the UK are judged most at risk because ultra-low interest rates and bond yields have fuelled rapid house price growth, said the report by Moody's Analytics.

July 27, 2015 3:00 pm

# IMF urges ECB to use firepower aggressively

Peter Spiegel in Brussels and Claire Jones in Frankfurt

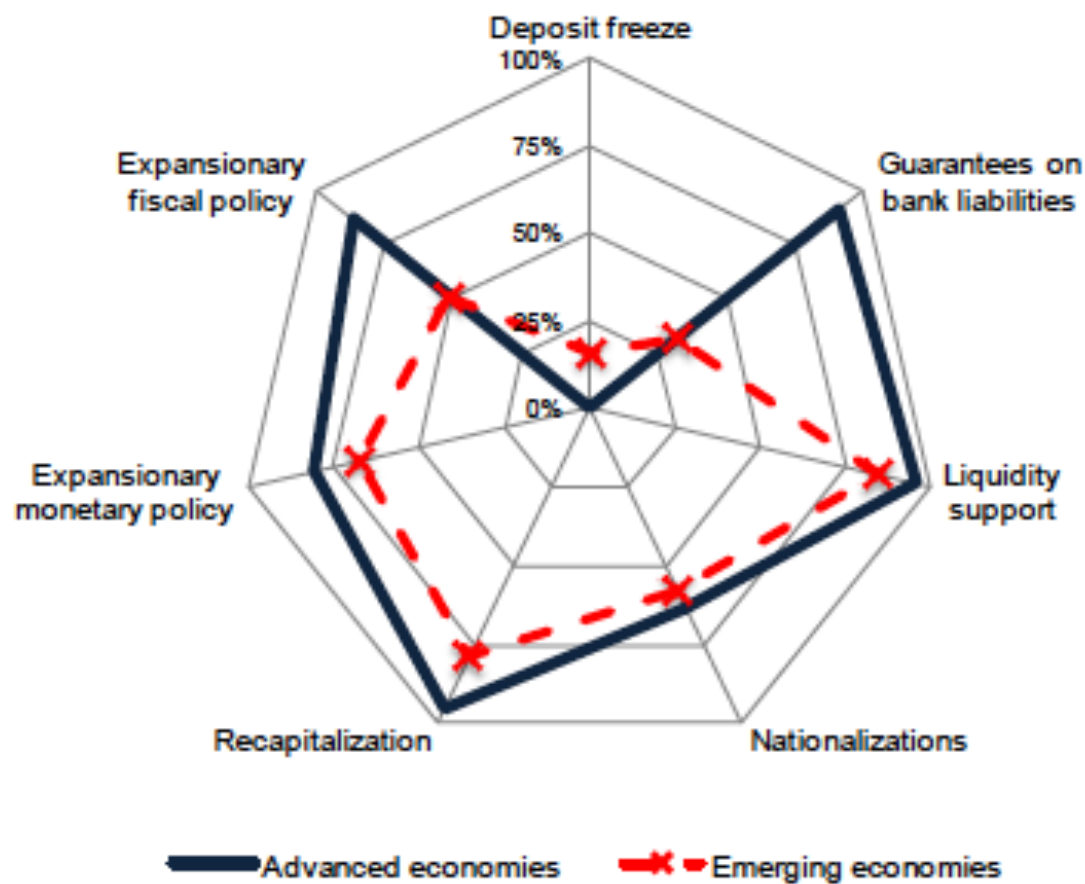
The eurozone's central bankers should be prepared to use their firepower more aggressively to prevent any economic uncertainty in Greece spreading across the currency union, the International Monetary Fund has warned.

The IMF guidance, contained in its annual report on the eurozone's economy published on Monday, comes despite the European Central Bank's unprecedented quantitative easing programme, in which it is purchasing €60bn in mostly government-backed bonds every month in an effort to stimulate investment and growth.

The IMF praised the QE programme, saying it “strongly supports” the ECB's current plans to keep the bond purchases running through September 2016, and credited the policy with preventing the six-month Greek crisis from causing more damage to the wider eurozone.

But in the 45-page report — and a separate statement that updates the IMF assessment in light of the recent Greek bailout agreement — the fund said Greece could still flare up as a crisis point and the ECB should “stand ready to extend the programme” if inflation remains below its target of below but close to 2 per cent.

Figure 6. Differences in the Mix of Crisis Policies



Source: Authors' calculations.

## Systemic Banking Crises Database: An Update

August 9, 2015 3:07 am

# European bond buying is ‘no good’ for infrastructure debt market

Chris Flood

[Print](#) [Clip](#) [Gift Article](#)

[Comments](#)

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Efforts to encourage pension funds to invest in infrastructure projects in Europe could be thwarted by the expansion of the European Central Bank’s bond-buying programme, according to Swiss Re, the world’s second-largest reinsurer.

Swiss Re said the ECB’s decision in June to start buying bonds from companies, such as electricity grid operators, railways and motorway operators, will crowd out pension funds and insurers from infrastructure debt.

Guido Fürer, its group chief investment officer, said it will do “no good” for the ECB to intervene in the infrastructure debt market.

# Banking Union: SSM and SRM, November 2014

The banking union was conceived to ensure that banks are stronger and better supervised and, should problems arise in the financial sector, they can be resolved more easily and without using taxpayers' money. It is made up of the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM), both of which are mandatory for all euro area Member States and open to all other countries in the EU.

Under the SSM, which became operational in November 2014, the European Central Bank (ECB) has become the banking supervisor for all banks in the euro area, directly responsible for supervising the approximately 123 largest banking groups. To help lay the groundwork for the SSM, an Asset Quality Review was carried out, involving an in-depth expert examination of some € 3.7 trillion of euro area banks' assets. A series of stress tests were also carried out. The aim of the exercises, which were concluded in October 2014, was to assess the resilience of EU banks in the face of adverse economic developments, in order to understand remaining vulnerabilities and give the ECB a clearer idea of the banks' financial health. The stress tests and the comprehensive assessment together helped to dispel doubts and restore confidence in EU banks.

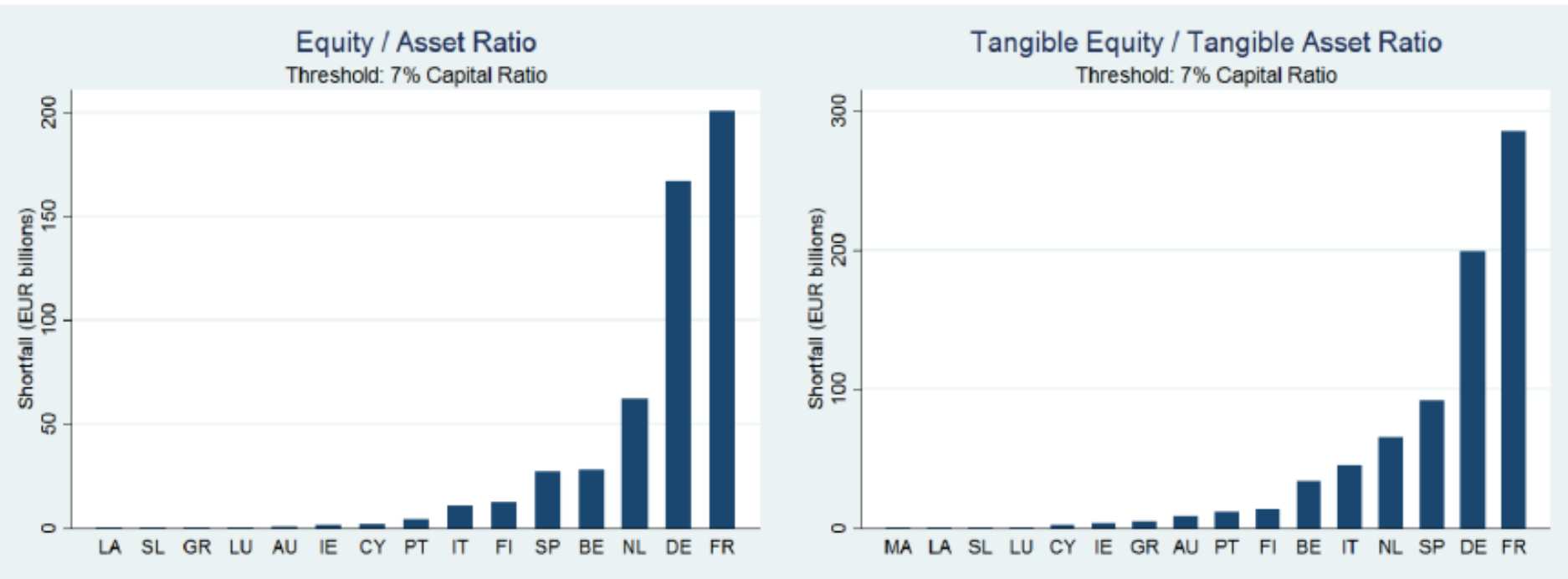
# Falling Short of Expectations? Stress-Testing the European Banking System

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Our results also suggest large shortfalls in core European countries such as France and Germany; Germany has many government-owned institutions that may require capital issuances and/or bail-ins. Interestingly, market measures of equity imply significantly greater capital shortfalls for France and Germany than book measures do. Moreover, while Italy's capital shortfalls are much higher relative to the market value of equity than Spain's, the two look similar when allowing for bail-ins on subordinated debt, due to greater subordinated bond holdings of Italian banks.



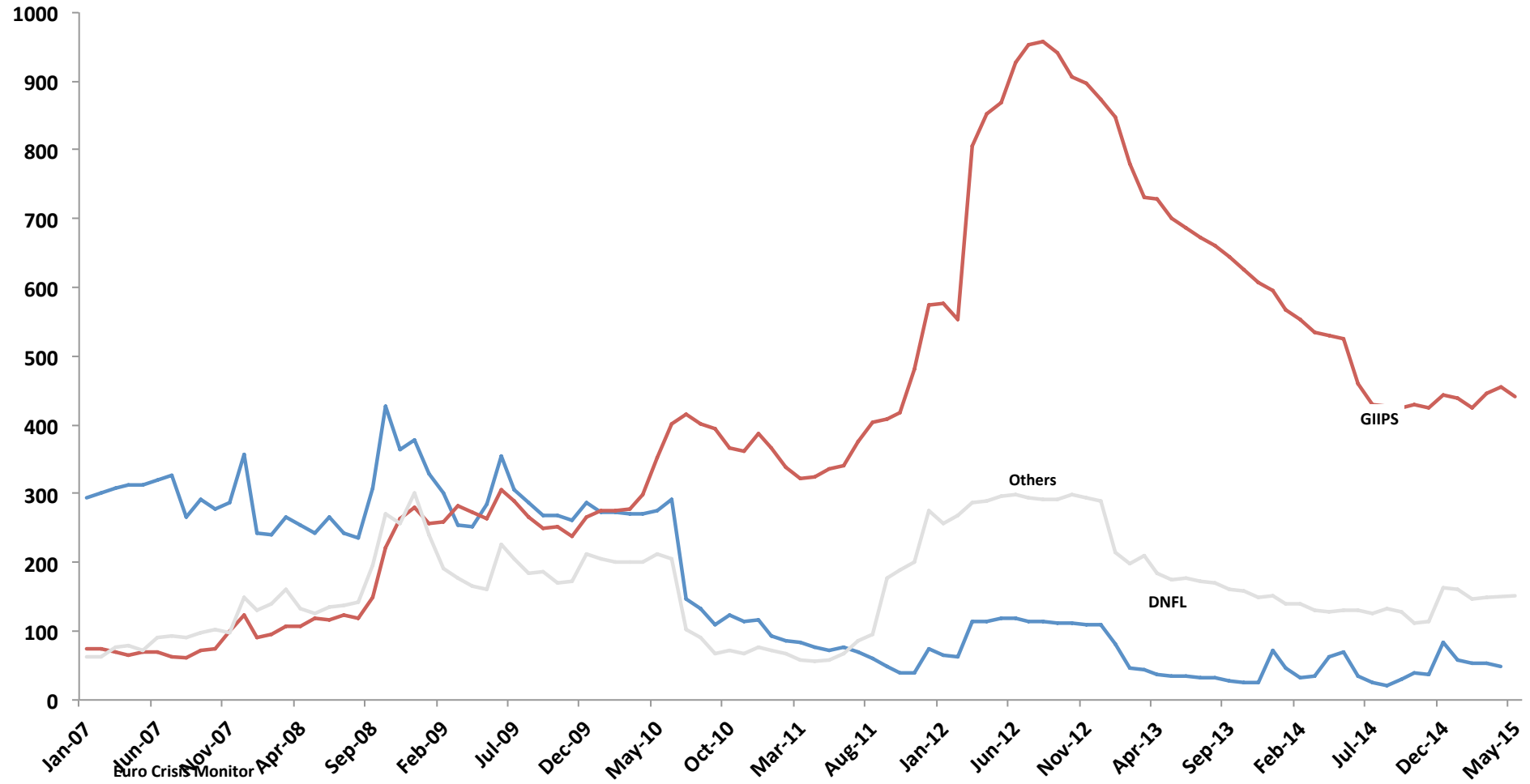


# Central Bank's Loans to Credit Institutions [bn. €]

GIIPS = Greece, Ireland, Italy, Portugal, Spain

DNFL = Germany, Netherlands, Finland, Luxembourg

Others = Austria, France, Cyprus, Belgium

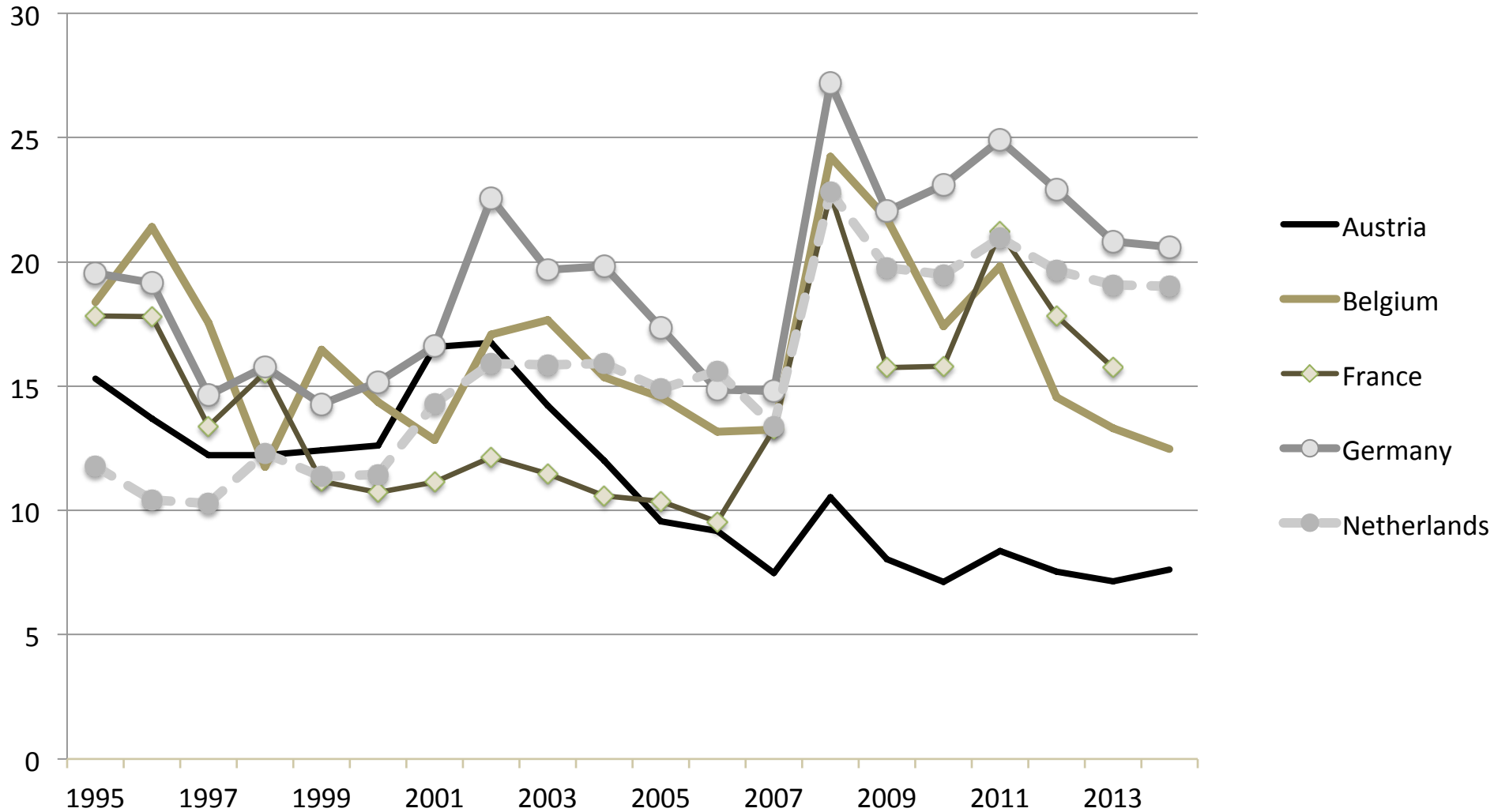


# ECB: So who pays when things go wrong?

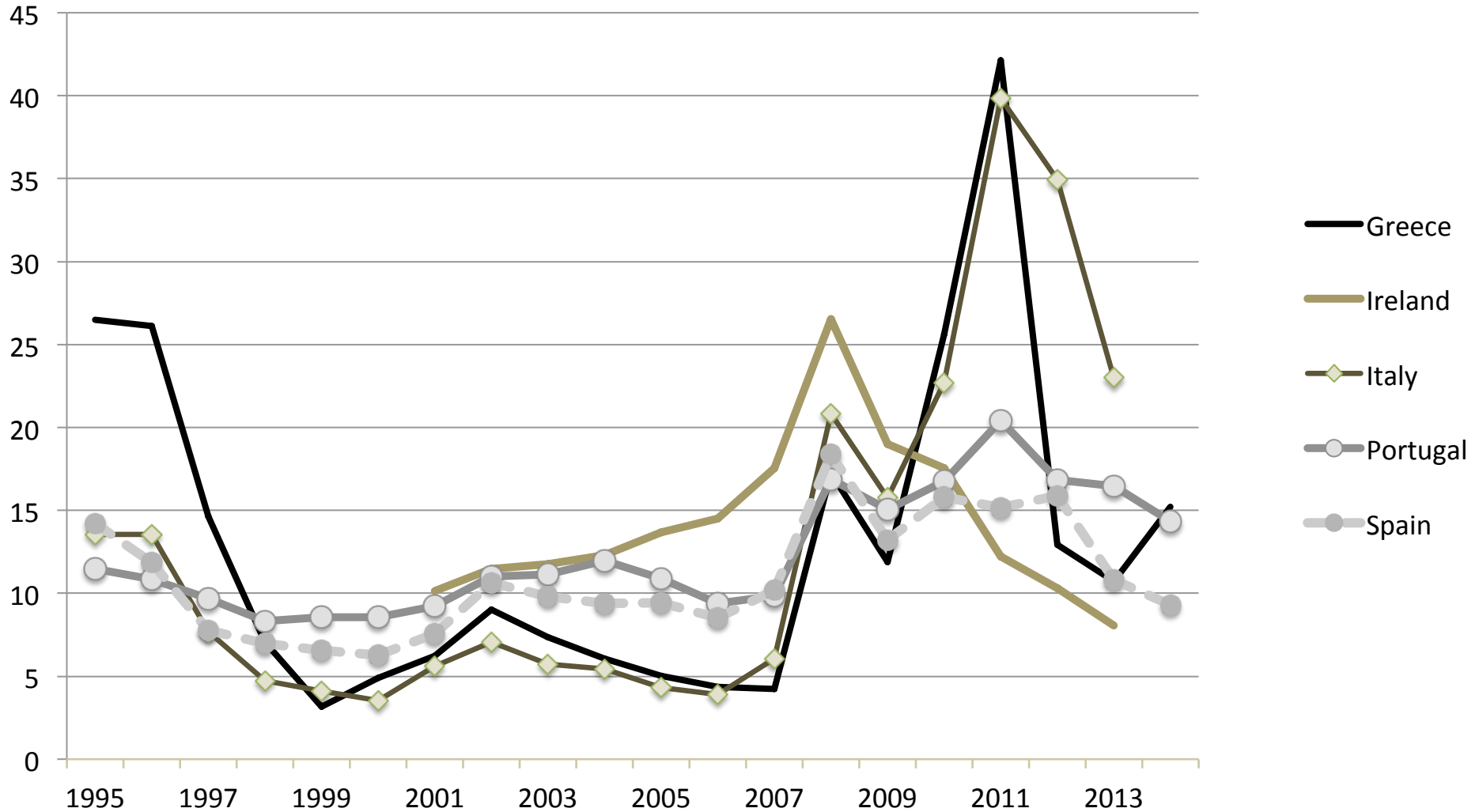
Impartial supervision at Union level under the SSM will make bank failures much less likely. When they do occur, however, the SRM will make it easier to deal with them. The SRM will cover banks overseen by the SSM/ECB. It is made up of a board, the Single Resolution Board (SRB) and a fund, the Single Resolution Fund (SRF). Once informed by the ECB that a bank is in trouble, the Board will be responsible for taking most decisions on the best course of action and will prepare for the resolution of the stricken bank. The fund, which will amount to € 55 billion within eight years, will be financed by all the banks in the banking union countries.

For situations when the SRF is not sufficiently funded by the banking sector, an effective common backstop will be developed, which will facilitate borrowing by the SRF. The euro area banking sector will ultimately be liable for repayment by means of levies, including ex post. The Single Resolution Board, which has been operational since the beginning of the year and will be fully operational (with a complete set of resolution powers) from January 2016, is the final piece in the banking union jigsaw. So a single EU authority will have the powers and resources to protect taxpayers from banks' failures.

Banking-sector leverage (assets/NVA), annual data, 1995-2014  
North-central EMU Nations

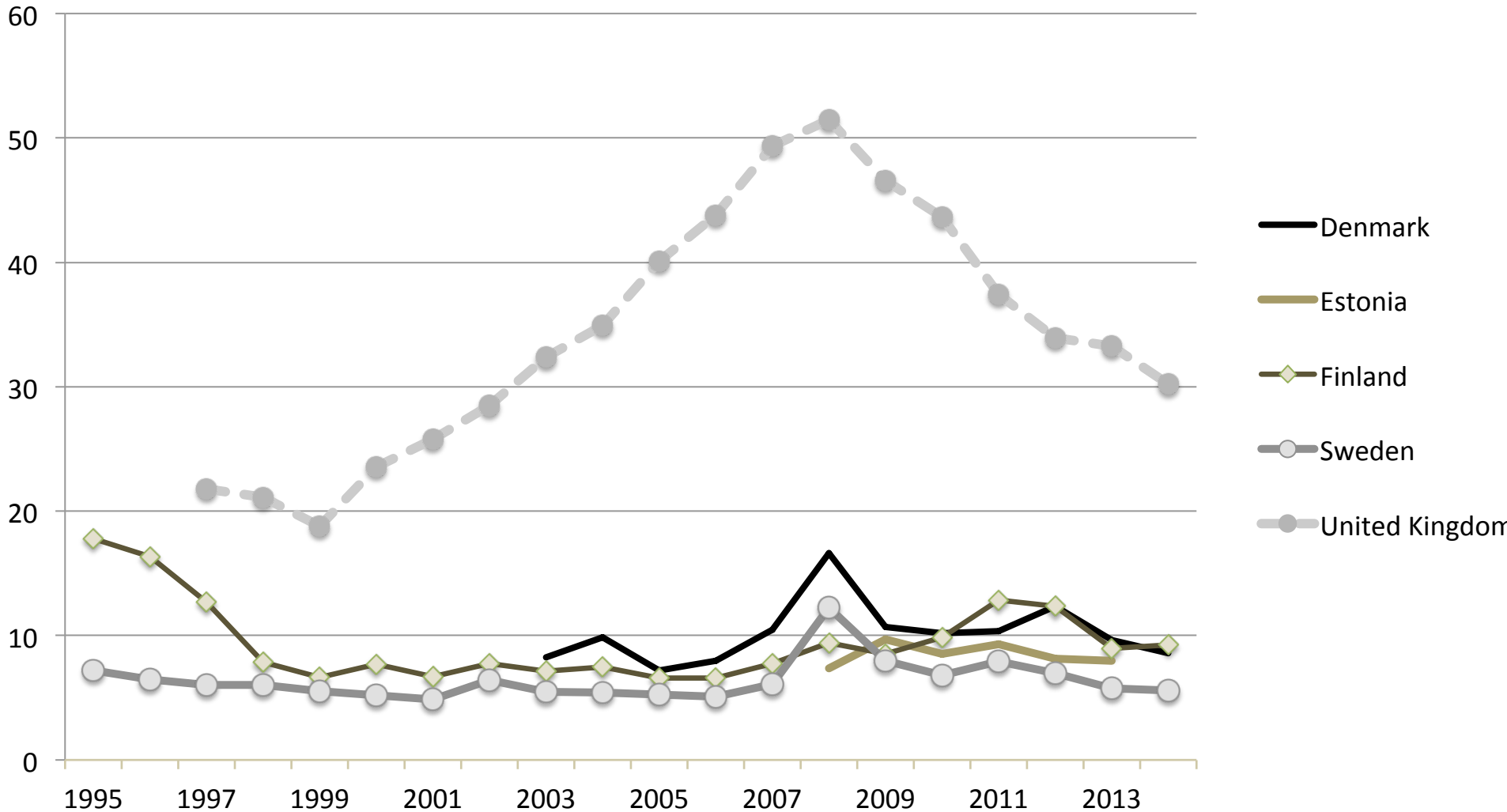


Banking-sector leverage (assets/NVA), annual data, 1995-2014  
GIIPS EMU Nations

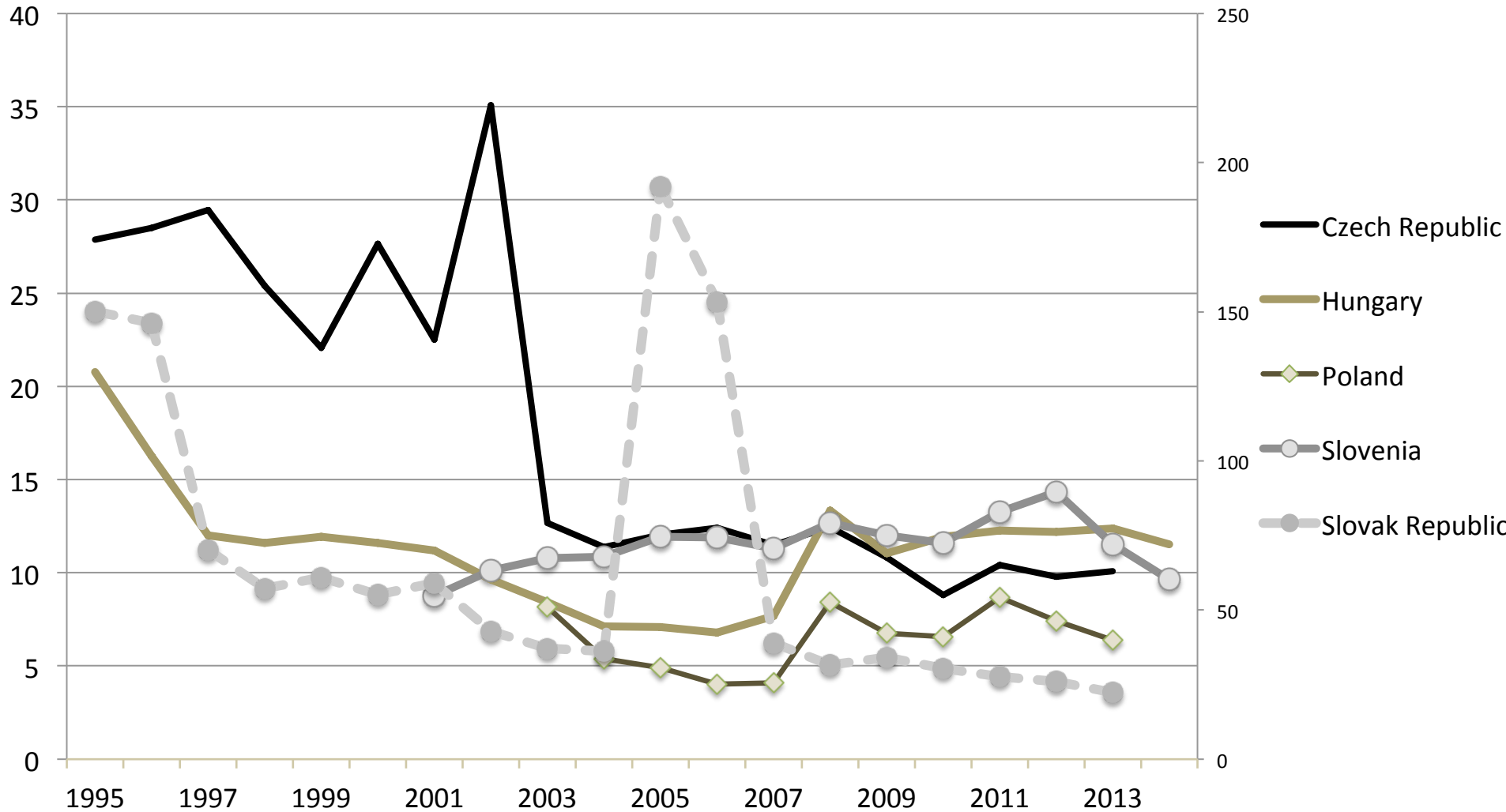


# Banking-sector leverage (assets/NVA), annual data, 1995-2014

## Northern EU Nations



Banking-sector leverage (assets/NVA), annual data, 1995-2014  
Northern EU Nations



# QE futures and Capital Market Union?

1. QE continues, US/UK interest rates stay low:
  - Bubble-led growth, financial markets searching for zero-sum speculative gain
  - Financial boom-bust cycles centred on economies
2. QE ends, interest rates raised in US, UK:
  - Financial bust in developing economies
  - Housing bust in several places (UK)
  - Capital Markets Union amidst the uncertainty:
    - Identify viable investment targets
    - Provide underwriting via European Union budgetary set asides
    - Initiate CMU to restore investor confidence in EU financing inflows

## 4. Critical evaluation, policy directions

- Future pathways: Austerity and liberalization; reconstruction?
  - Stagnation: Austerity is working, and growth will quicken when further liberalization unleashes financial-market-fueled investment now blocked by lack of an Anglo-American financial system.
  - Reconstruction: Restoring state guidance of the economy and reversing the shift toward over-reliance on market finance
- Strategic next steps: Hayek; Schumpeter; Polanyi; Keynes; Minsky; Kalecki; Kowalik
- Contextual consideration: the state of financial globalization



## The state of financial globalization

- Securitization becoming the dominant credit form
  - Not just “originate to distribute” loans, but making the world safe for securitizable fixed-income instruments
  - Consequence: two contracts on one cash-flow as a normal state of affairs
  - Result: Conflict of laws, resolved by the home country of the ultimate claim-holder (Brady Bonds to Sovereign debt)
- Competition in low interest-rate, slow-growth environments will involve thin margins and unpredictable, bubble-driven flows
  - Stockholder pressure on competing banks and more skin in the game will not preclude leveraging
  - Money markets are super-leveraged too via rehypothecation
- Regulators remain captured, whilst more forceful; insisting on more capital because of inability to control pace of innovation

# Strategic next steps through seven giants' eyes

- Hayek – All is fore-ordained, the market and choice must defeat the state and its absolutism
- Schumpeter – The space for the entrepreneur must be created and defended against the giant modern organization
- Polanyi – The state makes the space for the free market, and organizes it (ordoliberalism?)
- The market – the financial system (shadow banking nested into universal banking, eg) takes the shape it must only when the state does not interfere; and the state has interfered, so the state must be punished.
- Only then will credibility of the European Union be restored, and investment funds flow anew, in the new modern forms of abstract, globalized property rights.

# Strategic next steps through seven giants' eyes

- Polanyi – The state is only one part of a double movement protecting “the community” against market predation on the weak and powerless.
- So Keynes – Public spending and investment can provide infrastructure renewal and social protection for the weak
- Kalecki – Profits = investment; so how to make space for accessing and controlling the surplus, if it is state enterprise that engages in investment?
- Kowalik – is it too much to hope for a decentralized market socialism in which individual initiative (Schumpeter) coexists with adequate public provision? The road not taken in Eastern Europe...

# Strategic next steps: policy directions

1. A plan to restore more stable, more functional finance in Europe
  - Can the UK / City of London remain inside the “single market”?
2. Overcome reliance on the IMF for policy guidance and dispute resolution: trust in European judgment and in truly multilateral (global) institutions
3. A green and pink Social Reconstruction Plan for Europe
4. A reinvention of education and training
5. Strategic social-compact partnerships with nations in the developing world
6. Protection of workers’ rights and wages
7. Redefining credibility as a criterion for guiding policy