

The crisis in Europe:
The dead end road of the race to the
bottom

Özlem Onaran

University of Greenwich

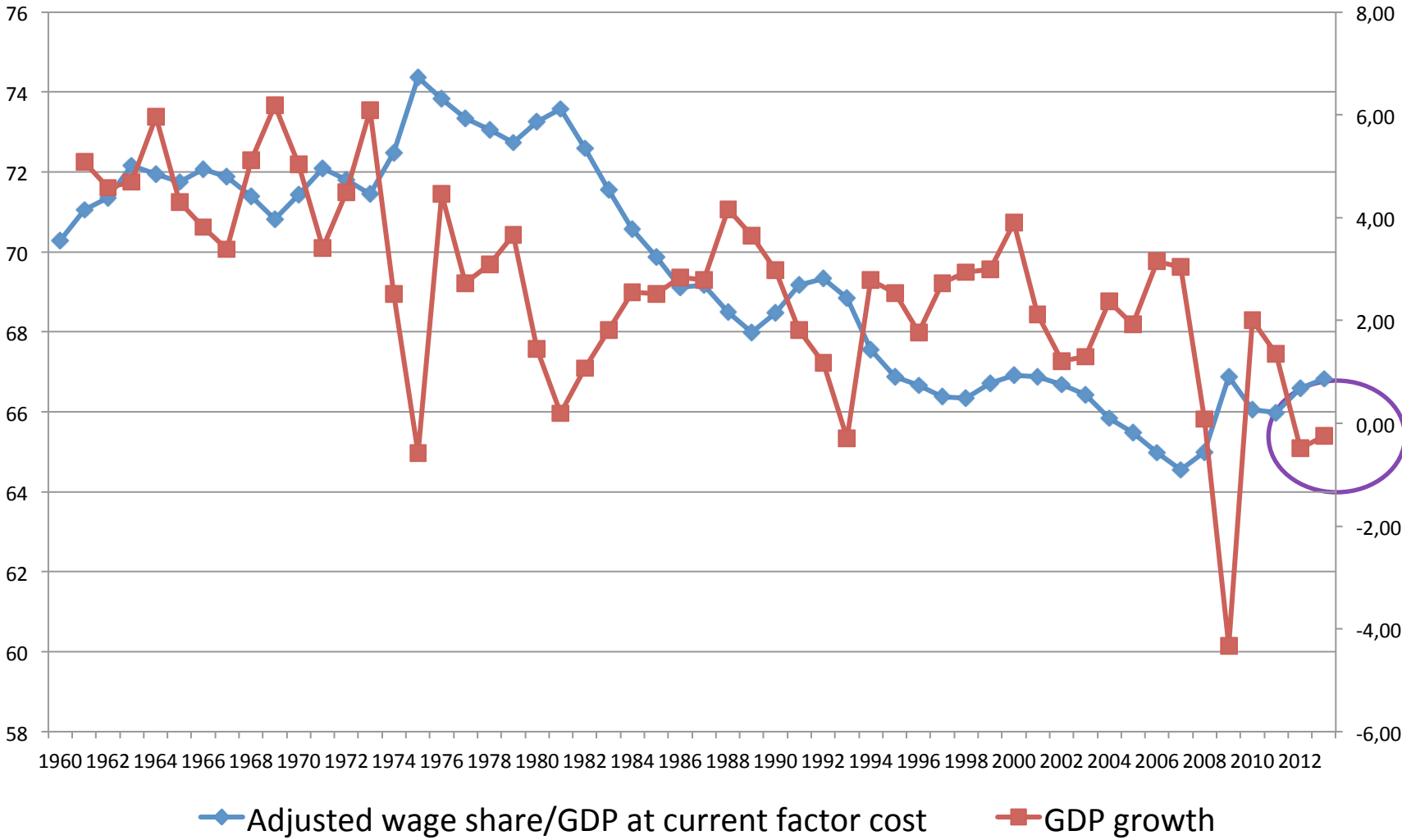
Outline

- What is effect of a wage cut on demand?
 - Empirical findings (Onaran and Galanis, 2012)
- Model
- Estimation results
 - Euro area
 - G20
 - Novelty: global multiplier
- Policy Conclusions

Crisis management and growth

- austerity packages, low wages, chronically low demand
- uncertainty about the recovery → new investments less likely
- income and jobs crisis
 - race to the bottom in the share of labour, 2010-11
 - A reason behind the crisis
- Recession in the Eurozone is back in 2012-13

Wage share vs. growth, EU15, 1960-2013



Caution: declining wage share in 2010-11, pay freeze and austerity → recession!

Source: Ameco, May 2013 revision

What is the effect of a decline in the wage share on demand?

- Neoclassical/'mainstream'
 - Positive; wages merely as a cost item
- Post-Keynesian/Neo-Kaleckian model
- Dual role of wages
- Increase in the profit share: + & - effects on aggregate demand
 - : the relative size of the consumption differential out of wage vs. profit income
 - +: the sensitivity of investment to profits (partial)
 - +: the sensitivity of net exports to unit labor costs
- Total effect on demand is ambiguous
 - : wage-led demand
 - +: profit-led demand
 - Bhaduri and Marglin (1990); Dutt (1984); Blecker (1989)
- Fallacy of composition: Macro – micro conflict
 - firm vs. aggregate
 - national vs. European or global level

Consumption (C)

Estimated as a function of wage and profit income

marginal propensity to consume (mpc) out of wages > mpc out of profits

Private Investment (I)

- Estimated as a function of sales prospects and profitability
 - past and current output
 - profit share
- Test also for the crowding in or out effects of public investment

Foreign sector

- stepwise approach
- domestic prices = $f(\text{nominal unit labor costs, import prices})$
- export prices = $f(\text{nominal unit labor costs, import prices})$
- Exports = $f(\text{export price/import price, } Y_{rw})$
- Imports = $f(\text{domestic price/import price, } Y)$
- Wage share $\downarrow \rightarrow$ unit labour cost \downarrow
- \rightarrow Export prices and domestic prices \downarrow
- Exports \uparrow & imports \downarrow

National and global multiplier effects

- National multiplier
 - private demand changes → changes in
 - Investment
 - Consumption
 - imports
- Global effects of a simultaneous fall in the wage share
 - Effects of changes in trade partners' wage share via changes in
 - import prices
 - trade partners' GDP

The effects of a 1%-point increase in the profit share

Wage led



	C/Y	I/Y	X/Y	M/Y	NX/Y	% change in total private excess demand
Euro zone-12	-0.439	0.299	0.057	0.000	0.057	-0.084
Germany	-0.501	0.376	0.096	0.000	0.096	-0.029
France	-0.305	0.088	0.036	-0.162	0.198	-0.020
Italy	-0.356	0.130	0.037	-0.089	0.126	-0.100
United Kingdom	-0.303	0.120	0.048	-0.110	0.158	-0.025
United States	-0.426	0.000	0.006	-0.031	0.037	-0.388
Japan	-0.353	0.284	0.028	-0.026	0.055	-0.014
Canada	-0.326	0.182	0.063	-0.203	0.266	0.122
Australia	-0.256	0.174	0.049	-0.223	0.272	0.190

The effects of a 1%-point increase in the profit share

	C/Y	I/Y	X/Y	M/Y	NX/Y	% change in total private excess demand
Turkey	-0.491	0.000	0.140	-0.144	0.283	-0.208
Mexico	-0.438	0.153	0.128	-0.253	0.381	0.096
Korea	-0.422	0.000	0.178	-0.181	0.359	-0.063
Argentina	-0.153	0.015	0.014	-0.178	0.192	0.054
China	-0.412	0.000	1.095	-0.891	1.986	1.574
India	-0.291	0.000	0.080	-0.230	0.310	0.018
South Africa	-0.145	0.129	0.000	-0.506	0.506	0.490

Summary of the multiplier effects at the national and global level

	The effect of a 1%-point increase in the profit share in only one country on private excess demand/Y	The effect of a 1%-point increase in the profit share in only one country on % change in aggregate demand (A*multiplier)	The effect of a simultaneous 1%-point increase in the profit share on the % change in aggregate demand (including effects of trade partners' export prices and GDP))
	A	B	D
Euro area-12	-0.084	-0.133	-0.245
United Kingdom	-0.025	-0.030	-0.214
United States	-0.388	-0.808	-0.921
Japan	-0.014	-0.034	-0.179
Canada	0.122	0.148	-0.269
Australia	0.190	0.268	0.172
Turkey	-0.208	-0.459	-0.717
Mexico	0.096	0.106	-0.111
Korea	-0.063	-0.115	-0.864
Argentina	0.054	0.075	-0.103
China	1.574	1.932	1.115
India	0.018	0.040	-0.027
South Africa	0.490	0.729	0.390

global GDP ↓ by 0.36%

A wage-led recovery scenario

	Scenario 2	
	Change in profit share	The % change in aggregate demand (includes national and global multiplier effects, i.e. changes in Pm and Yrw)
Euro area-12	-11.05	2.36
United Kingdom	-7.83	1.91
United States	-6.31	6.15
Japan	-16.71	1.49
Canada	-3.00	2.84
Australia	-3.00	0.03
Turkey	-18.41	10.81
Mexico	-3.00	1.45
Korea	-8.64	7.46
Argentina	-3.00	1.27
China	-1.00	5.56
India	-3.00	0.43
South Africa	-1.00	1.93

Global GDP ↑ by 3.05%

...What happens when wage share ↓?

- Estimation results, 1960-2007
 - (Onaran & Galanis 2012)
- If the wage share ↓ by 1% point:
- Consumption ↓ by 0.44% points (of GDP)
- Investment ↑ by 0.28% points
- Net exports ↑ by 0.06% points
- Aggregate private demand ↓ by 0.08% points
- +Multiplier effects: Aggregate demand ↓ by 0.13% points
- →EU as a whole has a wage-led demand regime,
 - although some individual member states may have a profit-led regime- e.g. if a small country, Austria, is the only one who decreases labor share, it can grow, but if every country does the same, they all contract
 - Intra European trade is high
- Austerity and wage deflation policies are contractionary; particularly if simultaneous
- Global race to the bottom by 1% (Estimations and Simulation for G20)→
 - EU GDP ↓ by 0.25%
 - global GDP ↓ by 0.36%
- Conversely a global wage-led recovery scenario: Global GDP ↑ by 3.05%, EU GDP ↑ by 2.4%

Policy Implications

- A vicious circle of wage cuts lead to lower growth and fewer jobs
- The dilemma of pay vs. jobs is not empirically validated for large economies as well as the EU and the global economy at large
- the limits of strategies of international competitiveness based on wage competition in a highly integrated regional or global economy
- From debt to insolvency for the private & the public sector?
 - ↑wage share : egalitarian; does not harm growth potential
- importance of wage/macro policy coordination
- Avoid beggar thy neighbour policies
- Recovery led by domestic demand & ↑ in the wage share
 - a reversal of the ↑ inequality –a factor behind the crisis