Stephan Schulmeister

The Eurozone – integration, des-integration and possible future developments

18th Monetary Policy Workshop at the Berlin School of Economics and Law, 12 – 13 October 2017
Overview

- Position 1: The euro itself is the problem, right and left populists stress different aspects
- Position 2: The finance-capitalistic “game” as a whole is the problem, the euro is the right within the wrong
- Comparing the two positions against the background of euro’s history
- Pre-history of the euro crisis: Building-up imbalances in the first half of the euro era (1999-2008)
- Asymmetric policy in Germany and in Southern Europe:
- Reciprocal benefits plus rising creditor-debtor-positions
- Crisis 2008f and Greek “confession” > no financial support >
- New game: Betting on state bankruptcy > Greece > Ireland > Portugal > Spain > Italy
- Draghi’s “Whatever it takes”-remark plus QE plus ignoring the fiscal compact enable Portugal, Spain and Italy to recover.
Financial balances by sectors

GERMANY

EURO AREA
without Germany

In % des BIP
-9.0 -8.0 -7.0 -6.0 -5.0 -4.0 -3.0 -2.0 -1.0 0.0 1.0 2.0 3.0 4.0 5.0 6.0 7.0

1999 2001 2003 2005 2007 2009 2011 2013 2015

In % of GDP
-9.0 -8.0 -7.0 -6.0 -5.0 -4.0 -3.0 -2.0 -1.0 0.0 1.0 2.0 3.0 4.0 5.0

1999 2001 2003 2005 2007 2009 2011 2013 2015

Households
Business sector
Government
ROW

Households
Business sector
Government
ROW
Overall production and investment

GDP

2008 = 100


Greece
Southern Europe
Germany
Euro area

Gross investment

2008 = 100


Greece
Southern Europe
Germany
Euro area
Long-term interest rates

Graph showing long-term interest rates for Germany, Greece, Spain, and Portugal from 1Q1990 to 1Q2016.
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Unemployment and unemployment benefits

Number of unemployed

Annual benefit per unemployed

- Greece
- Southern Europe
- Germany
- Euro area
Total exports and imports of Germany by partner countries

Exports
- Greece
- Portugal
- Spain
- Italy

Imports
- Greece
- Portugal
- Spain
- Italy
German current account
By partner countries

Bilions of €

Greece
Portugal
Spain
Italy

Bilions of €

Southern Europe
France
Euro18
World
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Current Account

In % of GDP

- 21
- 14
- 7
0
7


Greece
Portugal
Spain
Italy

In % of GDP

- 21
- 14
- 7
0
7


Greece
Southern Europe
Spain
Germany
Italy
Euro area
Unit labour costs and export prices

Unit labour costs

Export prices

1995 = 100

Greece
Southern Europe
Germany
Euro area
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Total exports and imports
Current prices

Exports
Imports

1995 = 100


Greece
Southern Europe
Germany
Euro Area
Three bear markets and the great crisis
Overall Balance

- Greece
- South Europe
- Germany
- Euro area

Structural Balance

- Greece
- South Europe
- Germany
- Euro area

Total and structural balance of government

11.10.2017
CDS premia and interest rates on long-term government bonds

GREECE

- CDS premia (left scale)
- Bond rates (right scale)

PORTUGAL

- CDS premia (left scale)
- Bond rates (right scale)
CDS premia and interest rates on long-term government bonds

ITALY

SPAIN

- CDS premia (left scale)
- Bond rates (right scale)
Long-term interest rates
Government debt in % of GDP
<table>
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<tr>
<th>Economic interests</th>
<th>Labor</th>
<th>Real Capital</th>
<th>Finance Capital</th>
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<tr>
<td>Conflicts of interests</td>
<td>Rising wages</td>
<td></td>
<td>Rising interest rates</td>
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<tr>
<td>Potential coalition partners</td>
<td>Real capital</td>
<td>Labor or finance capital</td>
<td>Real capital</td>
</tr>
<tr>
<td>Economic interest in state/government</td>
<td>Full employment policy Social security Education Public services</td>
<td>Anticyclical policy Growth policy: Infrastructure Education, etc.</td>
<td>Strong central bank Restriktive monetary policy Privatisation of social security</td>
</tr>
<tr>
<td>Political interests</td>
<td>Strong welfare state Strong trade unions</td>
<td>Weak welfare state Weak trade unions</td>
<td>No welfare state No trade unions</td>
</tr>
</tbody>
</table>
## Real and finance capitalism

<table>
<thead>
<tr>
<th>Implicit coalition</th>
<th>Real capitalism</th>
<th>Finance capitalism</th>
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</thead>
<tbody>
<tr>
<td>Labor &amp; Real capital</td>
<td>Real capital &amp; Finance capital</td>
<td></td>
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<tr>
<td>Corporatisms</td>
<td>Conflict</td>
<td></td>
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<tr>
<td>Complementary</td>
<td>Antagonistic</td>
<td></td>
</tr>
<tr>
<td>Targets of economic policy</td>
<td>Many: From full employment, high growth to social security and „fair“ distribution</td>
<td>Price stability, „sound“ public finances, regulation of policy, de-regulation of markets</td>
</tr>
<tr>
<td>„Power center“ of economic policy</td>
<td>Government</td>
<td>Central bank</td>
</tr>
<tr>
<td>Economic paradigm</td>
<td>Keynesianism</td>
<td>Monetarism/Neoliberalism</td>
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<tr>
<td>Diagnosis/Therapy</td>
<td>Systemic</td>
<td>Symptom-oriented</td>
</tr>
<tr>
<td>Financial conditions</td>
<td>Interest rate &lt; growth rate, „calm“ stock markets, stable exchange rates and commodities prices</td>
<td>Interest rate &gt; growth rate, boom und bust on stock markets, unstable exchange rates and commodities prices</td>
</tr>
<tr>
<td>Striving for profits focuses on</td>
<td>Real economy (Positive-sum game)</td>
<td>Finance economy (Zero-sum game)</td>
</tr>
<tr>
<td>Economic model</td>
<td>Social and regulated market economy</td>
<td>„Pure“ market economy</td>
</tr>
</tbody>
</table>
Long-term economic development in Western Europe
Exchange rates and global economic growth

![Diagram showing exchange rates and global economic growth]

- Effective exchange rate 4 Reserve currencies/dollar
- World GDP (right scale)


1986 = 100

In %
# Real and finance capitalism in Europe and US

<table>
<thead>
<tr>
<th>Institutional frame conditions</th>
<th>Macroeconomic framework conditions</th>
<th>Real capitalism</th>
<th>Finance capitalism</th>
<th>Mixed</th>
</tr>
</thead>
<tbody>
<tr>
<td>European Social Model</td>
<td></td>
<td>Europe until ~ 1973/80</td>
<td>Europe since ~ 1973/80</td>
<td></td>
</tr>
</tbody>
</table>
Guidelines of a New Deal for Europe

- Better balance between
  - Competition/cooperation
  - Economy/politics
  - Market/State
  - Technical/social innovations

- Striving for profits > real economy

- Globalization of politics

- Extension of the European Social Model by environmental components

- Budget consolidation through stable and green growth
The European Monetary Fund

- Agency and bank for financing euro governments
- Sells Eurobonds and offers Euro-Accounts
- At stable interest rates below the medium-term growth rate
- Unlimited guarantee by all euro states
- Full backing by the ECB
- Fully liquid, yet not tradable (like former German “Schatzbriehe”)
- Strict conditionality, not exclusively restrictive
Components of a New Deal I

- Interest rates below rates of economic growth
- Target zones for key exchange rates
- Stabilization of price paths of key commodities like crude oil
- General financial transactions tax (FTT)
- „Re-education“ of FAB banks > serving the real economy
- Global strategies for the environment
- Transnational infrastructure in EU
- Social minimum standards in EU
Components of a New Deal II

- Innovative working time models:
  - Adjustment to business cycle (e.g., German „Kurzarbeitsmodell“)
  - Long-term reduction of life time working hours

- Investment in environment (from building insolation to new forms of mobility)

- Recovery of the welfare state (redistribution, education, public health and pension system, etc.)

- Support the young generation (jobs and flats)
Pricing of exhaustible and environmentally harmful resources

- Basic conditions, in particular for fossil combustibles:
  - Exhaustible plus social costs (climate change etc.)
  - Equilibrium price path: Oil price must rise continuously faster than general price level
  - (Derivatives) markets fail completely >
  - CO2 taxes and emission trading also fail
  - Producers and consumers change energy use mainly through strong and reliable price signals
  - Long amortization periods of energy saving investments
Target: Limit climate change to plus 2°C

No-regret-option ("low carbon roadmap"): Price increase by 370 € per ton CO2 or 0.74 € (0.93 $ at 1 € = 1.25 $) per liter crude oil >

Final oil price in $: 0.63 (at present at 100$/barrel) plus 0.93 = 1.56*159 = 248 $ >

If target to be reached by 2020: Annual price increase by 12%

Basic conditions, in particular for fossil combustibles:

Exhaustible plus social costs (climate change etc.)
Financing the „New Deal“

Guidelines: Shift in incentive structure from
- Finance towards real world activities
- Saving towards consumption and investment
- Wealth concentration towards a more equal distribution
- Ressource-intensive towards „greener“ activities

General financial transactions tax
Higher taxes on financial returns
Increase of high/top income tax rates
Higher wealth taxes (including inheritance tax)
Environmental taxes (instead of emissions trading)