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Neo-mercantilism, inequality, financialisation and the euro crises

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Abstract: This paper considers three aspects of the euro zone crises. It begins by a discussion of the roles of current account imbalances and the pursuit of neo-mercantilist type policies particularly by Germany. It then moves on to the ways in which inequality has played a role in the crisis, and in particular the role of 'structural reforms' in the labour market and elsewhere as the perceived route out of crisis but which will likely generated further inequality. In the final main section some of the developments in the financial sector are related with the euro crisis.

Key words: Financialisation, inequality, labour market reforms, euro.

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Introduction

The Economic and Monetary Union (EMU) (the members of which we refer to as the euro zone) faces many dimensions of crisis. There are doubts on its continued existence – what may be termed an existential crisis, and even more doubts as to whether its continued existence can be combined with economic prosperity in all regions of the euro zone. There are crises of unemployment currently (late 2013) over 12 per cent across the euro zone, and over 25 per cent in Greece and Spain. The sovereign debt crises rumble on. The balance of payments crisis has involved a pattern of current account imbalances which have tended (up to the financial crises of 2007/09) to widen, and notably the German current account position to move from close to balance to large surplus (of around 7 per cent of GDP at its peak). The current accounts imbalances were reflected in a set of capital account imbalances.

This paper considers three aspects of the euro zone crises. It begins by a discussion of the roles of current account imbalances and the pursuit of neo-mercantilist type policies particularly by Germany. It then moves on to the ways in which inequality has played a role in the crisis, and in particular the role of 'structural reforms' in the labour market and elsewhere as the perceived route out of crisis but which will likely generate further inequality. In the final main section some of the developments in the financial sector are related with the euro crisis.

2. Neo-mercantilism and current account imbalances

The euro zone is, of course, a fixed exchange rate system with respect to the member countries and whilst changes in the nominal exchange rate between member countries is ruled out changes in the real exchange rate can and do occur. Many of the issues of the maintenance of a fixed exchange rate regime are well-known -- member countries have to experience common patterns of inflation (otherwise current account deficits and surpluses emerge and grow), and in a broad sense countries have to pursue mutually consistent policies with regard to trade as one country's surplus is another country's deficit. It is well-

known that countries within the EMU experienced differences in inflation and in the evolution of their competitiveness and prior to the financial crisis widening current account imbalances had been experienced. Since the financial crisis there has been some element of narrowing of those imbalances as a result of differential rates of declines in economic activity and in deflation of wages. Figure 1 provides a summary in which the scale of current account imbalances with surpluses of over 5 per cent of GDP in some countries (Finland, Netherlands, Germany at times), and deficits of over 5 per cent of GDP in many other countries.

Figure 1: near here

Figure 2: near here

There are two remarkable features which come from this Figure. The first is the degree of persistence of the differences in inflation between member countries, and the implication which that has for the real rates of interest in face of the single nominal rate of interest as set by the ECB as part of its monetary policy. The 'one size fits all' problems of monetary policy are well-known which are exacerbated in a currency union covering disparate economic systems. The particular aspect which we remark on here is the divergence of real interest rates in the face of convergence of nominal interest rates. In Figure 2 the period is split into 1998 to 2009, and then 2009 to 2014 (forecast) which illustrates the sharp changes and the degree to which wage deflation (as reflected in unit labour costs) has been used.

The other side of current account imbalances is, of course, capital account imbalances with extensive cross-border capital flows where the gross flows would be substantially greater than the net flows which are recorded in the capital account. The current account imbalances have seen a corresponding set of cross-border capital flows. These capital flows could have been interpreted in terms of the success of the EMU in the integration of capital markets and the removal of exchange rate risk in cross-border borrowing and lending.

The second is the degree to which the movement in relative competitiveness is contrary to expectations that relative prices would change to reduce current account imbalances when the adjustment of exchange rate changes was no longer available. The optimal currency area (OCA) literature portrayed relative price flexibility as one of the conditions for a currency area under the assumption that a fall in demand in one region would be met by a fall in prices in that region etc.; yet the competitiveness indicators tend to move in the direction which widened rather than reduced imbalances.

One response is that the relative trends in competitiveness, in wage and price inflation can be ascribed to different wage and price setting arrangements in member countries such that there are differences in underlying trends of wage and price inflation, differences in response to global inflation and (euro) exchange rate changes, to demand movements and to ECB monetary policy (e.g. credibility of central bank and any impact of that on price and wage determination, response to interest rate).

Bibow (2013) traces the history of the German current account position in the post-war period, and remarks that 'a new and far more remarkable shift in current account positions then occurred under the euro regime in the 2000s: as Germany's deficit of one percent of GDP at the start of Economic and Monetary Union (EMU) turned into a surplus of over seven percent by 2007.' He rightly argues that the euro area crisis is not primarily a sovereign debt crisis, but rather a twin banking and balance of payments crisis. The policy measures have though focused on the debt/deficit issues without any attention to resolving the current and capital account imbalances.

Lucarelli (2012, p.210) points the finger at the 'The peculiar institutional characteristics of the ECB and Germany's incessant neomercantilist pursuit of competitive disinflation within the eurozone have created the conditions for this self-reinforcing and seemingly irreversible process of cumulative decline and stagnation.'

The pursuit of different strategies with regard to the current account and trade positions resulting in different current account outcomes create particular difficulties within EMU

through the insistence on a common approach to budget deficits imposed by the Stability and Growth Pact and now re-inforced (as indicated below) by the 'fiscal compact'.

Figure 3: Budget deficit positions

The features of the record on budget deficits are the degree to which even prior to the financial crisis the national budget deficits exceeded the 3 per cent limit of the Stability and Growth Pact, the extent to which the budget position for the euro zone countries as a whole was in deficit and that for most countries there was on average a budget deficit. This raises the question of why were there budget deficits in the face of the SGP requirements—it could be through persistent profligacy on behalf of governments which can be remedied through stricter enforcement (effectively the route being followed by the fiscal compact) or it may (as we would argue) reflect that there is a tendency in economies for savings to exceed investment which then requires some combination of budget deficit and overseas lending

From the national income accounts relationship S (private savings) – I (investment) = BD (budget deficit) + FA (financial account), there are two points of significance. The first relates to the relatively low private sector investment in Germany, albeit highish relative to rate of growth, with savings relatively high (which could be ascribed to the sifts in the distribution of income towards profits). With savings high relative to investment, fears over size of budget deficit (bring in debt brake), leads to high financial account outflow. Attempts to actually meet the debt brake requirements could well lead to even higher current account surpluses and financial capital outflows. And, of course, one country's surplus requires others to be in deficit.

The second comes when savings is predominantly set by profits, then the equilibrium relationship reads (taking the case where savings out of wages are zero) such that savings out of profits $sP = I + BD + FA$ where investment, budget deficits and current account surplus each have positive impacts on profits. Thus the net exports can be viewed as favourable to profits (in Germany).

The maintenance of a fixed exchange rate regime (as the euro area is with regard to relationship between member countries) requires a similarity of inflation between members of the exchange rate regime. It may be hoped that such similarity emerges from realisation by price makers and wage negotiators of that requirement and set prices and wages accordingly. It seems such a hope underlay the eurozone as no policy measures were in place to secure such a similarity of national inflation rates. But matters have turned out differently. A fixed exchange rate regime also requires the establishment of sustainable current account positions which are mutually compatible. The present arrangements within the eurozone do not permit through exchange rate or other adjustments the establishment of sustainable current account positions, and the pursuit of surpluses in some countries throws others into deficit.

Inequality and the labour market

In Arestis and Sawyer (2013) we argued that the macroeconomic policy framework of the EMU should be viewed as one of neo-liberalism with beliefs in self-adjusting markets to achieve full employment (or at least the non-accelerating inflation rate of unemployment, NAIRU), the 'independence' of the central bank with a central objective of inflation targeting and assignment of policy decisions to bankers and out of the hands off politicians and the limitations on budget deficits under the Stability and Growth Pact (SGP) and specifically for the notion of balanced budget over the cycle (with the implication that the private sector generates sufficient demand for full employment). But the formal arrangements for the SGP and the operation of the euro focused on macroeconomic policies, and although there were implicit beliefs in the stability of the market economy and its ability to achieve a supply-side equilibrium, there was not a formal statement of micro-economic policies and of the promotion of markets. The policies of the European Union itself with regard to those matters could be said to have neo-liberal elements, notably in the limits on State aid and the liberalisation programmes in the area of public utilities. Policies with regard to labour markets were more difficult to classify-- the 'open method of

co-ordination' provided a much looser set of arrangements (as compared with say the Stability and Growth Pact) and notions of a 'Social Europe' were still in the air with the roles of social partners in wage setting, consultations etc.. The European Employment Strategy itself would be difficult to classify with many cross currents. This may well have reflected the rather different institutional arrangements and outlooks on labour market policies in the member countries. These differences necessary meant that the construction of common policies were fraught with difficulties. It could also be seen as a factor in the 'one size fits all' problems of a single monetary policy in that the inflationary mechanisms differ across countries, and may have been a factor in the observed differences in wage and price inflation across noted above.

Within the EMU institutional arrangements, the European Central Bank frequently called for de-regulation and 'structural reforms' in its pronouncements: such a call was a constant in the *Monthly Bulletin*. An example: 'The Governing Council [of the ECB] ...urges all euro area governments to decisively and swiftly implement substantial and comprehensive structural reforms. This will help these countries to strengthen competitiveness, increase the flexibility of their economies and enhance their longer-term growth potential. In this respect, labour market reforms are key, with a focus on the removal of rigidities and the implementation of measures which enhance wage flexibility. In particular, there is a need for the elimination of automatic wage indexation clauses and a strengthening of firm-level agreements so that wages and working conditions can be tailored to firms' specific needs. These measures should be accompanied by structural reforms that increase competition in product markets, particularly in services – including the liberalisation of closed professions – and, where appropriate, the privatisation of services currently provided by the public sector, thereby facilitating productivity growth and supporting competitiveness' (ECB, 2011, p. 7).

'Structural reforms' are often not defined, and this is particularly so in the recent *Treaty on Stability, Coordination and Governance in the Economic and Monetary Union*, discussed

below . But there can be little doubt as to what is in mind. In an interview with the Wall Street Journal, Mario Draghi, President of the ECB stated that the most important structural reforms were ‘first is the product and services markets reform. And the second is the labour market reform which takes different shapes in different countries. In some of them one has to make labour markets more flexible and also fairer than they are today. In these countries there is a dual labour market: highly flexible for the young part of the population where labour contracts are three-month, six-month contracts that may be renewed for years. The same labour market is highly inflexible for the protected part of the population where salaries follow seniority rather than productivity’.¹

The continuing focus on austerity and structural forms is illustrated by, for example, ‘The European Commission President, Jose Manuel Barroso, recently made the recommendation that fiscal consolidation (read “austerity”!) must continue in Europe, and that the European Union (EU) member states “should now intensify their efforts on structural reforms for competitiveness”. He specifically highlighted the need for comprehensive labour market reforms as “the best way to kickstart job creation”.²’ (Hermann, 2013, p.1). The call for structural reforms is not new but has intensified with the ‘fiscal compact’. ‘The structural reforms adopted during the crisis have generally expanded the possibilities for companies to increase profits at the expense of workers; despite the upward redistribution of wealth, from labour to capital, the outcome of austerity and structural adjustment for growth and recovery has, so far, been miserable.’ (Hermann, 2013, p.2)

The recent history of EMU and member countries can be seen as involving substantial shift in the neo-liberal direction with regard to labour market policies. Here we highlight two features. The first relates to the *Treaty on Stability, Coordination and Governance in the Economic and Monetary Union*, the inter-governmental agreement incorporating the ‘fiscal

¹ <http://www.ecb.europa.eu/press/key/date/2012/html/sp120224.en.html>, accessed 20th March 2012.

² Jose Manuel Barroso, Press Conference Brussels. 29 May 2013

compact', which has two elements. One element is that member countries are to be legally obliged to adopt a balanced 'structural' budget such that 'the budgetary position of the general government of a Contracting Party shall be balanced or in surplus' and this is interpreted as 'the annual structural balance of the general government is at its country-specific medium-term objective, as defined in the revised Stability and Growth Pact, with a lower limit of a structural deficit of 0.5 % of the gross domestic product at market prices' (Article 1 of Treaty); a stricter policy imposed on countries with debt ratio exceeding 60 per cent of GDP where the Treaty makes it 'possible to open an EDP [excessive deficit procedure] on the basis of the debt criterion. Member States with government debt ratios in excess of 60% of GDP should reduce this ratio in line with a numerical benchmark, which implies a decline of the amount by which their debt exceeds the threshold at a rate in the order of 1/20th per year over three years. If they do not, they could be placed in EDP depending on the assessment of all relevant factors and taking in particular into account the influence of the cycle on the pace of debt reduction.' (Article 4). The deficit requirement is to be written into a country's national constitution or equivalent. This re-inforces the neo-liberal attitude to fiscal policy which was already present under the SGP.

The other element, and immediately relevant to our theme here, is 'structural reforms'. The *Treaty* includes that a country which is subject to an 'excessive deficit procedure' 'shall put in place a budgetary and economic partnership programme including a detailed description of the *structural reforms* which must be put in place and implemented to ensure an effective and durable correction of its excessive deficit.' (emphasis added). This is effect formalises, albeit only in the context of the Excessive Deficit Procedure, the push for neo-liberal structural reforms.

The second shift which has occurred at the national level has been the degree to which 'structural reforms' have been implemented in the aftermath of the financial crisis and 'great recession'. In some cases, Greece being a notable example, these have been a

requirement imposed by the Troika. Table 1 is a summary of recent labour market reforms in a range of EU countries which can be seen as in the neo-liberal direction.

Table 1 near here

The Troika imposed conditions on Greece included: 'To restore competitiveness and growth, we will accelerate implementation of far reaching structural reforms in the labor, product, and service markets. Indeed to give a strong upfront impetus to unit labor cost reductions, and protect employment, we have already reformed the collective bargaining framework and reduced the minimum wage as a prior action for this program. And to reduce market rigidities, boost productivity, and increase long-term growth potential we are implementing reforms in product and service markets and improvements in the business environment.' 'Place more emphasis on securing reductions in unit labor costs and improvements in competitiveness, through a combination of upfront nominal wage cuts and structural labor market reforms. In unison with the elimination of rigidities in product and service markets, these are expected to lower costs and facilitate the reallocation of resources towards the tradable sectors, stronger growth, and higher employment.' (Greece: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding, 15th March 2012: available at <http://www.imf.org/external/np/loi/2012/grc/030912.pdf>. There were specific reductions to be made in pensions and other social transfers

The EMU countries have shared the common experience of rising inequality and falling wage share – Figures 4 (inequality) and 5 (wage share) provides some summary statistics to illustrate. It is not our intention to address directly the relationship between inequality and the euro crises. We note the arguments that rising inequality impacted on financial instability with rising consumer debt levels etc., an explanation particularly advanced for the USA and (to some degree) the UK. The shifts in the distribution of income from wages to profits, notably in Germany, may well have impacted on the level of aggregate demand

and on growth (where German growth rate averaged less than 1 ½ per cent during the 2000s even prior to the financial crisis). Some of the effects of these shifts are:

- '1. Stagnating nominal unit labour costs have contributed to sustained real undervaluation due to the fixed exchange rate regime of the European Monetary Union and thus stimulated exports from Germany.
2. Firms have taken advantage of stagnating nominal unit labour costs to strongly increase their profit margins. This has, in turn, reduced household incomes relative to GDP, thereby weakening private consumption demand. The large net savings of the German corporate sector are not well explained and clearly require further research.
3. The rising income inequality and uncertainty of private households, partly the result of labour market and welfare state reforms, have contributed to higher precautionary saving in a context of a labour market traditionally based on internal rather than external flexibility, a high gender pay gap and passive macroeconomic stabilisation policies.

While the different reactions of private households to rising inequality in the United States and China seem to be to a large extent due to differences in the credit market, our discussion of the German case suggests that other institutional factors, such as labour market institutions (internal vs. external flexibility, gender relations) and macroeconomic stabilisation policies have also played an important role. Moreover, the specificities of the euro area's fixed exchange rate regime are also important in understanding the effects of wage deflation on both real effective exchange rates and firms' profit margins.' (van Treeck and Sturm, 2012, pp.48/49)

Although further investigation is required we do not base our argument here on the idea that rising inequality was a significant factor in the generation of the financial crisis. But in line with the literature on wage-led vs. profit-led regimes would see these shifts as having tended to lower aggregate demand and thereby the level of economic activity. Through the effects on savings, these shifts may have raised the need for budget deficits. The downward shift in the wage share in Germany had consequences for the domestic level of

demand and the need to promote exports along with the improved 'competitiveness' of German exports.

The second question is the nature of employment and labour market policies at the EU and national levels, and specifically within EMU the direction of travel in terms of labour market and employment policies. As noted above, there have been incessant calls from institutions such as the ECB for 'more flexible labour markets' and for 'structural reforms'. It has yet to be established that a neo-liberal agenda is the appropriate one for all countries (and whether it would be acceptable to the peoples of the countries). A general question to be raised here relates to the implicit view that there is a single 'best' model which is appropriate for all countries no matter what their previous policies, institutions and traditions. The question can be asked as to whether there is any evidence to support the view that the type of 'structural reforms' which the EMU, ECB and the Treaty promotes would bring improved economic performance.

Two broad views on what type of labour market arrangements are conducive to good economic performance (and what is deemed to constitute good performance differs also) are identified: this involves much simplification and mixtures of the views can no doubt be found. This dichotomy is used to highlight the debates. One broad view would envisage that a competitive labour market, which approximates the conditions envisaged in a perfectly competitive vision of the economy, would be conducive for good economic performance. Wages would be set in flexible manner by the interaction of demand and supply, bringing the labour market into equilibrium. Relative wages would adjust to balance demand and supply of labour, and that labour is efficiently allocated between different sectors and between different skill levels etc.. There would be a balance between demand for and supply of labour, which would mean full employment with all those who seek work at the going wage would be employed). This approach would emphasise the roles of flexibility of relative wages, the determination of wages without intervention of government (in say the form of minimum wage legislation) and without trade unions and collective bargaining, and

the allocative function of relative wages with movement of labour from low demand to high demand sectors.

The other broad view would emphasise the positive role of secure employment and long-term contracts, supported by employment protection legislation. The encouragement for training and skill formation, the push for higher productivity rather than lower wages as the way to reduce unit labour costs etc., would feature here. Further, trade union involvement, worker representation can have positive effects on work organisation, skill formation etc.. Higher wages encourages capital-labour substitution, raising labour productivity and induced technical change. Long-term contractual relationships encourage commitment and loyalty, and the development and retention of idiosyncratic knowledge. See, for example, Vergeer and Kleinknecht (2010) for arguments along these lines.

'the results clearly show that employment and income protection institutions have a distinctive impact on unemployment in corporatist labour markets. In these regimes, I find that strict employment protection legislation is actually associated with lower unemployment. This indicates a strong complementarity between strict employment protection and high internal flexibility. Furthermore, the increasing effect of unemployment benefits on unemployment is much weaker in corporatist labour markets' (Sturn, 2013, p.250).

There is now much evidence (some of which we summarise in Arestis and Sawyer, 2013, Chapter 6) that the lower the pay the worse, not the better. A couple of further examples make the point. Baccaro and Rei (2006) summarise their empirical results as follows: they provide "very little support for the view that one could reduce unemployment simply by getting rid of institutional rigidities. ... Changes in employment protection, benefit replacement rates and tax wedge do not seem to have a significant impact on unemployment." (p. 150). Vergeer and Kleinknecht (2010) "Superior growth of labor input in flexible Anglo-Saxon economies is *not* due to superior GDP growth. Over a long period (1960–95), it has been due to a lower growth of labor productivity when compared to 'rigid'

European economies. Only after 1995, the picture changed as the ICT boom enhanced U.S. labor productivity growth. At the same time, several European countries experienced a worsening labor productivity performance as they gradually engaged in wage-cost saving flexibilization of their labor markets.

Policies designed to reduce wages will likely increase unemployment – particularly when such reductions are taking place in a range of countries. Evidence supports the view that economies are wage-led rather than profit-led and hence that lowering wages would reduce demand and hence raise unemployment (see, for example, Lavoie and Stockhammer, 2014). When exports are important, lower wages in a country may boost exports; but in a relatively closed economy such as the European Union that effect is likely to be small. We can share the view that “Our central conclusion is that pursuing labour market flexibilization with the aim of increasing employment via export-led growth is bound to fail, especially if fiscal austerity prevents government spending from picking up the slack in global demand”. (Capaldo and Izurieta, 2013, p. 23).

Financialisation, financial sector and the financial crisis

The perceptions of a euro zone crisis and its many dimensions arose somewhat after the financial crisis (if that is dated as itself becoming evident from the second half of 2007 onwards with intensification in September/October 2008 marked by the collapse of Lehman Brothers). We would argue that the ‘great recession’ particularly evident in 2009 threw into sharp relief the problematic nature of the Stability and Growth Pact with its emphasis on budget deficit limits. The initial response was in general to allow deficits to rise as the automatic stabilisers slowed down the extent of the recession, though this was relatively quickly followed by an intensification of the limits on deficits and debt level under the ‘fiscal compact’, as discussed above. The ‘fiscal compact’ threatens to become a ‘suicide pact’ as each member state seeks to apply austerity measures to reach a balanced structural budget, which we have argued is likely to be unattainable (Sawyer, 2013)

However, the problems of the eurozone cannot be ascribed to the financial crisis, though that crisis has highlighted those problems. It should first be noted that whilst there was a widespread though not universal recession across the eurozone (as across many parts of the world), it could not be said that there was a financial crisis engulfing the euro area as a whole: and this has been reflected in the use of the term North Atlantic financial crisis by some (Jessop, 2013 for example). That is not to say that there have not been various crises at the euro area level and at the national levels. But the causes and nature of those crises vary across countries. The financial crises took different forms in the eurozone member countries. In some (e.g. Greece, Italy) the initial effects came from the contagion of the 'great recession' rather than a crisis within their financial system, with the depressing effects on economic activity and on the budget deficit position. In some, there was a contagion impact coming from purchases by the financial sector of 'toxic' assets (mortgage backed securities etc) notably from the USA but relatively little which could be ascribed as internally generated crisis and an absence of housing related boom whether of house prices and/or a construction boom. In others the financial crisis in effect struck after a few years when banks were in difficulties owing to devaluation of many of their assets, including government debt. Then there were countries in which there were (generally housing related) booms and then busts – Ireland being the prime example, and later Spain. The onset of the financial crisis highlighted the 'one size fits all' problems of an 'independent' central bank (in this case the ECB) in a diverse monetary union. The policy objective of the ECB was given as price stability, with a single policy instrument of the policy interest rate. The lack of convergence of inflation rates between countries resulted in a lack of convergence of real interest rates, and in that respect a lack of financial integration between the member states. It generated the perverse situation where member countries with high inflation countries had low or negative real interest rates whereas the ideas of inflation targetting would suggest that such countries should have relatively high real interest rates (to dampen down inflation). The continuing differences in

inflation had their impact on relative competitiveness and fed into widening current account imbalances. The 'one size fits all' problem kicked in with a vengeance when credit expansion rates differed markedly with property/construction booms in Ireland and Spain, for example. At least in so far as central bank policies were concerned there was not the possibility of differentiated policies to address the differences (it cannot be assumed that a national central bank and authorities would have responded to the construction and housing bubbles in a manner which would have defused them).

The so-called independence of the ECB necessarily limits co-ordination with other macroeconomic authorities. There was a hesitancy to act with the lowering of interest rates in the early phase of the crisis under the influence of inflation rate above target in an inflation targeting environment. The more serious issues arose from the ambiguities of the attitudes of the ECB towards acting as a lender of last resort towards sovereign debt and towards banks.

The introduction of a single currency with the removal of exchange rate risks between member countries facilitated cross-border borrowing. This plugged in to the general moves to financial integration between member states, which in turn can in the eurozone context be viewed as one aspect of financialisation (“...financialization means the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of domestic and international economies”, Epstein, 2005). ‘One central pillar of this strategy [neo-liberal of counter reform envisaging a comprehensive roll-back] is financial liberalisation, i.e. the removal of capital controls and other non-tariff barriers to cross-country capital flows. As a consequence, financial market exploded during the 1990s in terms of turnover and market capitalisation on European stock markets. This generated an intense process of restructuring of the financial sector, which is still evolving’ (Frangakis and Huffschmid, 2006, p.38).

The processes of financialisation fed into the euro crisis though much of the causes of that crisis can be laid at the door of poor policy design, and failures to address current account

imbalances between member countries. The financial integration between member countries facilitates large capital flows which not only corresponded to the current account imbalances but also feed into credit and consumer debt booms in some countries which would prove unsustainable. Further, when loans turned into non-performing ones then banks stability was threatened with loans made in one country threatening banks stability in others. The policy arrangements at the ECB were not conducive to addressing asset price inflation and credit booms which fed into the generation of crises.

Concluding remarks

The euro zone is a fixed exchange rate system without possibilities of nominal exchange rate adjustments (other than a country's exit from the euro) which have large current account imbalances. Those imbalances have arisen from a combination of

- (i) lack of regard to current account positions when the euro was formed. Whilst there was some attention to the stability of a country's exchange rate prior to membership of the euro zone (albeit often within a wide margin), there was no concern as to whether the exchange rate was compatible with a sustainable current account position;
- (ii) the differential movements between countries in terms of price inflation, unit labour costs and competitiveness which fed into widening current account imbalances;
- (iii) the pursuit of an essentially neo-mercantilist policy by Germany and which has resulted in a squeeze on wages in Germany.

Current account deficits in countries with particularly large deficits in the late 2000s have declined but largely through savage reductions in income and employment in those countries reducing imports. Little has been done to enable sustainable current account positions and high levels of employment.

The counterpart of current account imbalances is capital account imbalances and the flows of capital from surplus to deficit countries. The cross border capital flows were stimulated by the single currency (and the removal of exchange rate risk) and financial integration. These cross border flows played a significant role in the way in which the euro crisis played

out as, for example, loans made by banks from Northern European countries to Southern European households, firms and government became non-performing.

From the national income accounting relationships, it can be readily seen that differences in current account positions undermine attempts to impose common budget deficit requirements on national governments.

The actions of the Troika and the 'structural reforms' as ways of addressing the euro zone crisis including the current account imbalances threatens to increase inequality and represent a shift towards further neo-liberal policies with regard to the labour market. These policies are pursued in the name of increased flexibility and being employment friendly. We have argued that, on the contrary, such policies may well harm productivity and reduce employment. The policies are advocated on the basis of the benefits of a more 'flexible' labour market, whereas we argue that the evidence does not support that³.

The financial crisis of 2007/09 is viewed here more in terms of bringing underlying design faults of the Eurozone and policy mistakes to the fore, rather than as a cause of the euro zone crisis. The 'one size fits all' dilemma of Central Bank policy within a currency union is exacerbated by differences of financial systems between member countries, and the ECB lacks the policy tools to address differential inflation and also to address asset price inflation and credit booms which fed into the generation of the financial crises.

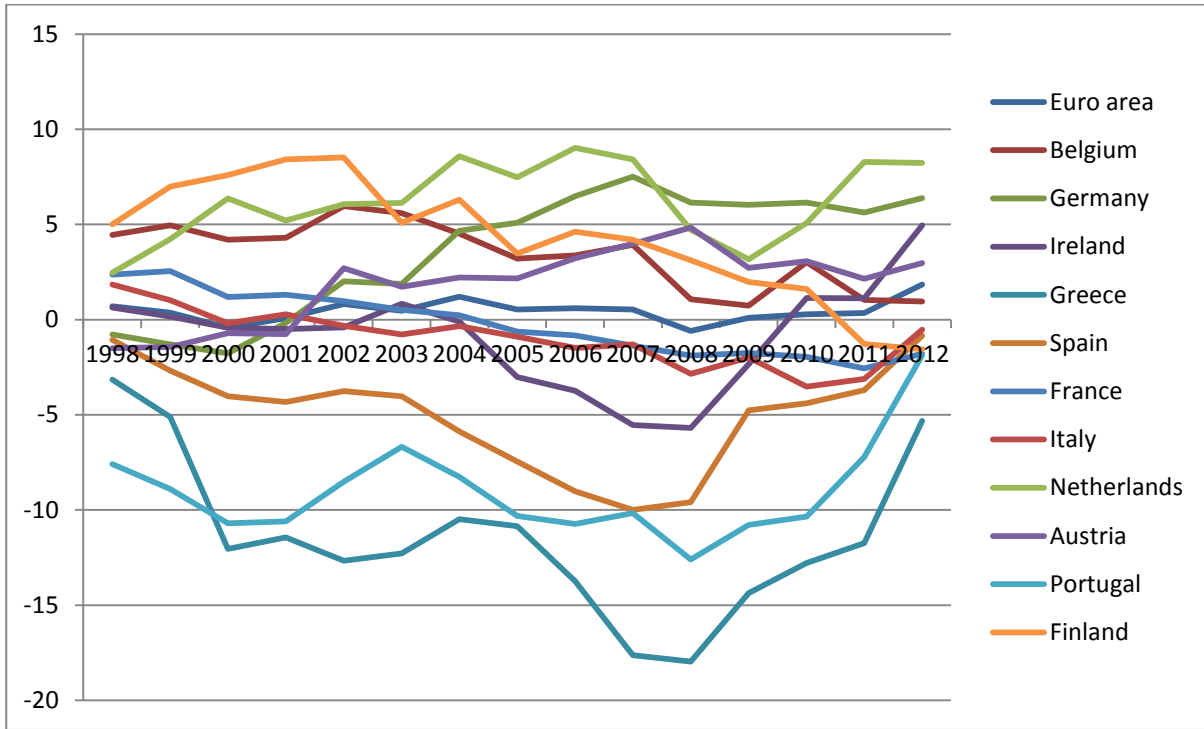
³ These arguments are further developed in Arestis and Sawyer (2013, 2014).

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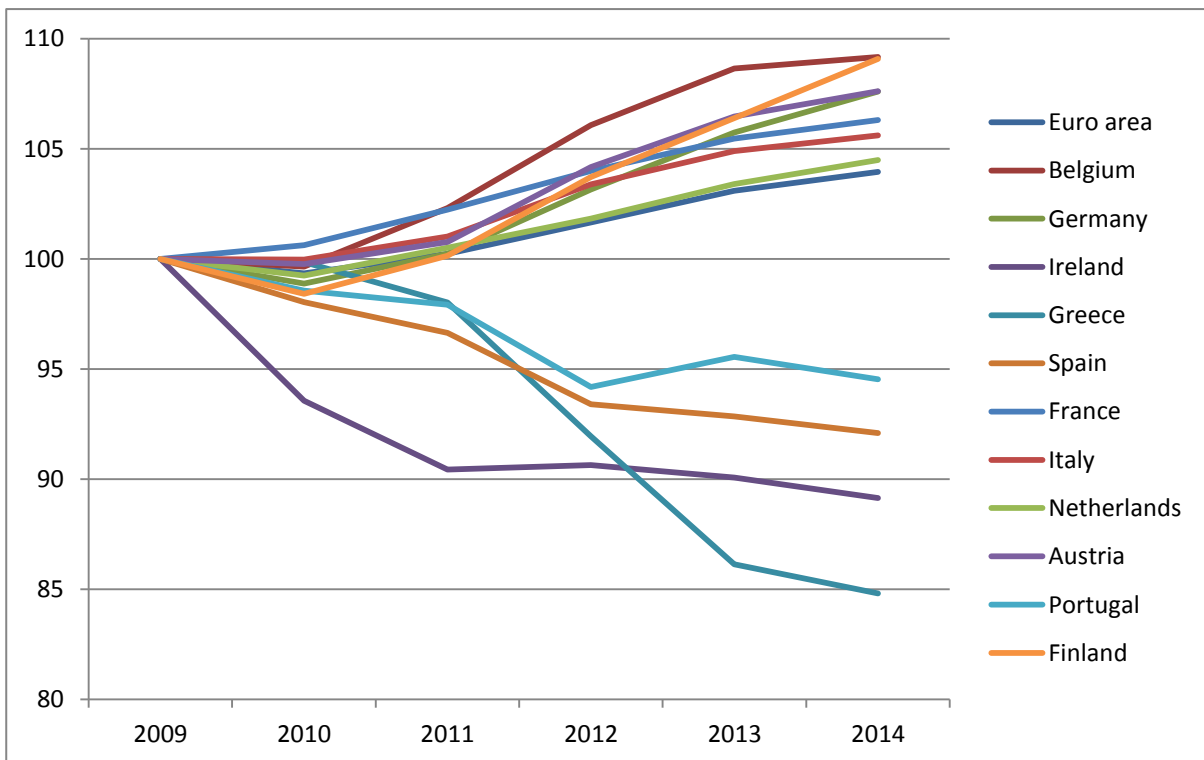
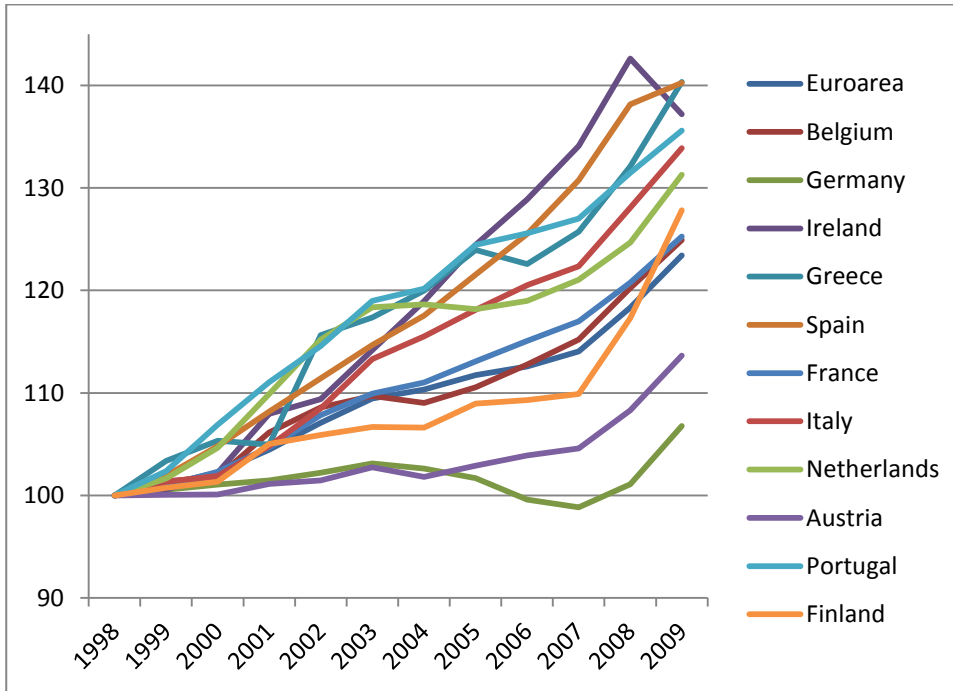
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Figure 1: Current account positions (as percent of GDP)



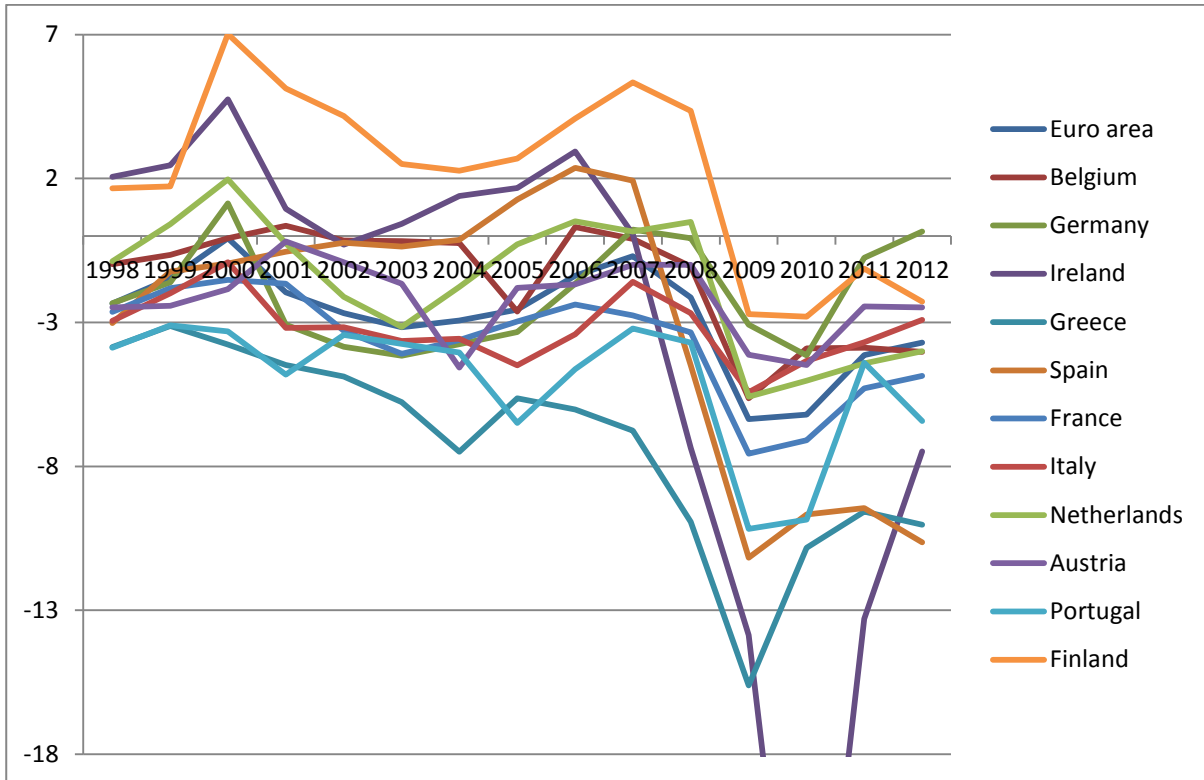
Source: Calculated from AMECO data base

Figure 2: Unit labour costs



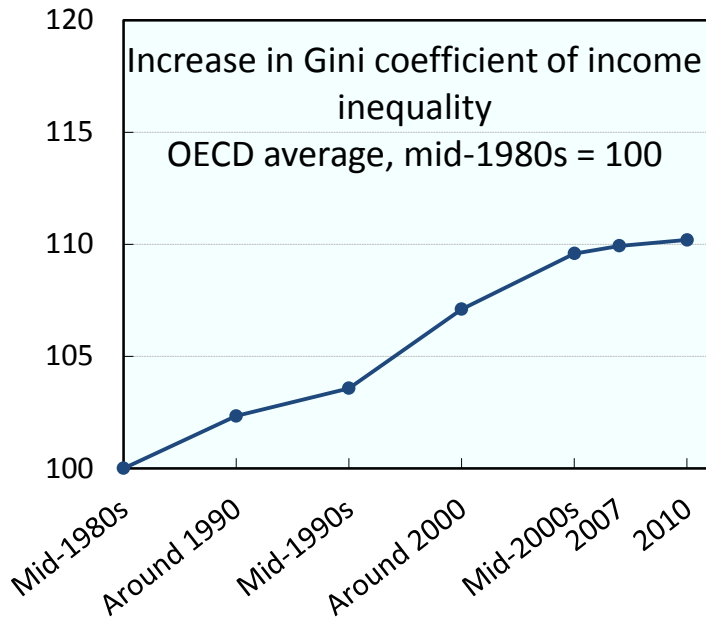
Source: Calculated from AMECO data base

Figure 3: Budget deficits



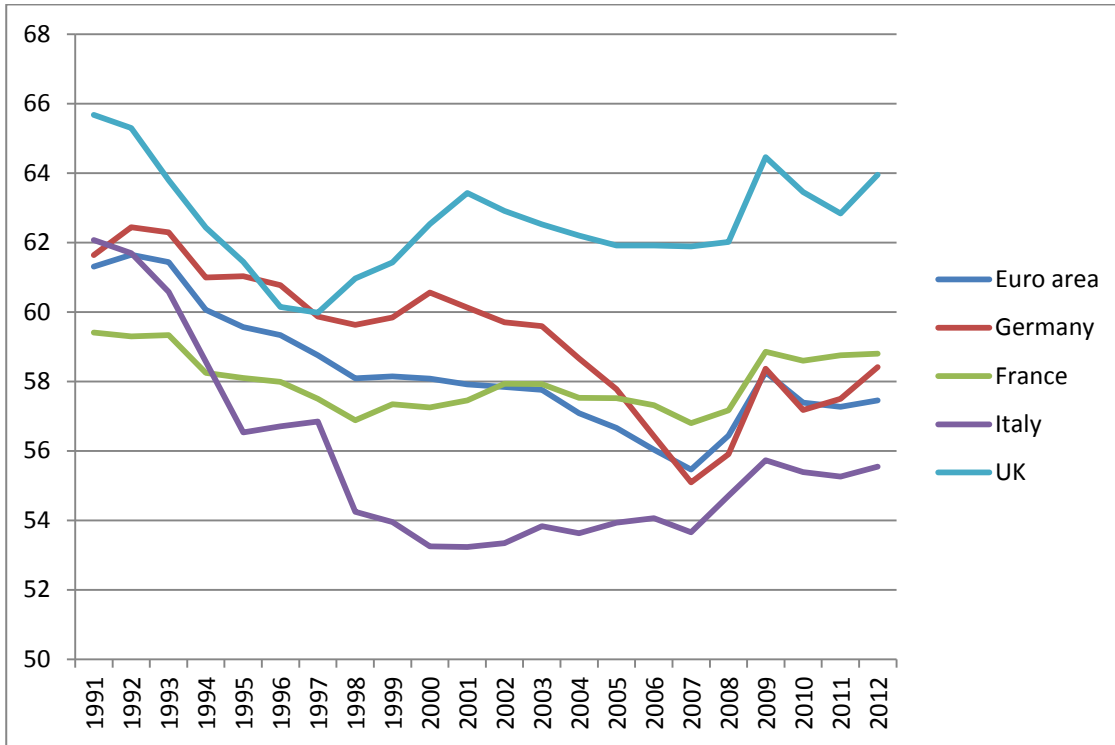
Source: Calculated from AMECO data base

Figure 4: Inequality



Source: [OECD Income Distribution Database \(www.oecd.org/social/income-distribution-database.htm\)](http://www.oecd.org/social/income-distribution-database.htm)
<http://stats.oecd.org/Index.aspx?DataSetCode=IDD>

Figure 5: Wage share



Source: Calculated from AMECO data base

Table 1: Labour Market Reforms during the crisis

Promotion of non-standard employment	
Promotion of fixed-term employment and agency work	EE, EL, LT, RO, PT
Introduction of new employment contracts with less pay and job security	EL, ES
Extension of probation periods	ET, GR, RO
Reduction of job security	
Weakening of employment protection for civil servants	EL
Weakening of employment protection for particular vulnerable groups of employees	EE, HU, RO
Shortening of notice period	EL, ES
Increasing thresholds and reducing obligations for mass layoffs	EE, EL, ES, RO
Changes in the definition of fair and unfair dismissals	ES, IT, UK
Reduction of severance pay	EE, ES, EL, PT
Restriction of access to court and reduction of fines for unfair dismissals	HU, UK
Elimination or weakening of the right to be reinstated after an unfair dismissal or after a mass layoff	ES, IT, RO

EE= Estonia, EL =- Greece, ES = Spain, IE = Ireland, IT = Italy, LT = Lithuania, LV = Latvia, HU = Hungary, PT = Portugal, RO = Romania, UK = United Kingdom

Source: Hermann (2013)

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THE ABSTRACT OF THE PROJECT IS:

The research programme will integrate diverse levels, methods and disciplinary traditions with the aim of developing a comprehensive policy agenda for changing the role of the financial system to help achieve a future which is sustainable in environmental, social and economic terms. The programme involves an integrated and balanced consortium involving partners from 14 countries that has unsurpassed experience of deploying diverse perspectives both within economics and across disciplines inclusive of economics. The programme is distinctively pluralistic, and aims to forge alliances across the social sciences, so as to understand how finance can better serve economic, social and environmental needs. The central issues addressed are the ways in which the growth and performance of economies in the last 30 years have been dependent on the characteristics of the processes of financialisation; how has financialisation impacted on the achievement of specific economic, social, and environmental objectives?; the nature of the relationship between financialisation and the sustainability of the financial system, economic development and the environment?; the lessons to be drawn from the crisis about the nature and impacts of financialisation? ; what are the requisites of a financial system able to support a process of sustainable development, broadly conceived?

THE PARTNERS IN THE CONSORTIUM ARE:

Participant Number	Participant organisation name	Country
1 (Coordinator)	University of Leeds	UK
2	University of Siena	Italy
3	School of Oriental and African Studies	UK
4	Fondation Nationale des Sciences Politiques	France
5	Pour la Solidarite, Brussels	Belgium
6	Poznan University of Economics	Poland
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9	Centre for Social Studies, University of Coimbra	Portugal
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11	National and Kapodistrian University of Athens	Greece
12	Middle East Technical University, Ankara	Turkey
13	Lund University	Sweden
14	University of Witwatersrand	South Africa
15	University of the Basque Country, Bilbao	Spain



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