EUROPE’S DOWNFALL LIES IN ITS PROPOSED SALVATION

NIKOLAS KOWALL, AUSTRIA (HTTP://OPEDSPACE.COM/AUTHOR/NIKOLAUSKOWALL/) / EUROPE (HTTP://OPEDSPACE.COM/CATEGORY/EUROPE/) / OCTOBER 29, 2014 (HTTP://OPEDSPACE.COM/2014/10/29/)

By Nikolaus Kowall

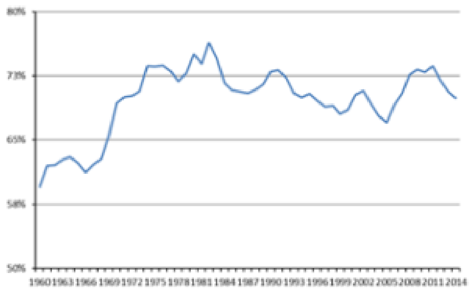
European economic policy has been predetermined for years in Berlin. It has recently signaled again that it does not want to deviate from the current austerity policy (http://www.washingtonpost.com/opinions/harold-meyerson-germany-poses-a-threat-to-its-own-economy/2014/10/15/38eeac6e-5497-11e4-892e-602188e70e9c_story.html). ***Market liberal elites have applied this forced policy for years, and as a result the economy of the Euro Zone has been driven into a dead end. Even worse, the more the impact of their policy is felt, the more aggressively they call for measures to prevent the decline of the continent. However, a comparison with the US shows: Nothing could contribute more completely to the decline of the EU than these exact measures.***

Europe was the most developed region of the world 100 years ago. Two world wars weakened its political, cultural and economic power and dominance significantly. According to historian Eric Hobsbawm, in 1945, as Europe lay prostrate, the US produced almost two-thirds of the world's industrial output. Up until the early 1980s the countries of Continental Europe in particular were able to pursue an amazing catch-up process. By 1982 the twelve original members of the Euro Zone were able to achieve an economic output per capita that stood at 76 percent of the US level of wealth. The US and Great Britain posted slower rates of development, and they fell behind Continental Europe and Japan.

In the late 1970s and early 1980s, governments in the United States and Europe began to experiment with new forms of economic control. Economic policy was inspired by the Monetarist paradigm of Milton Friedman. According to the economist Engelbert Stockhammer, this change meant a conscious "shift in priorities towards price stability, even at the cost of mass unemployment." Across the Atlantic, however, Monetarism was only a temporary fad. In the mid 1980s the US made a moderate departure from the policy, and shortly after that it broke with it definitively. By contrast, Europe had, in the words of the economist Heiner Flassbeck, "embarked on a long and momentous relationship" with Monetarism.

That is exactly the point where the old continent lost its connection to US development. After the initial set back to the convergence process, in the late 1980s it seemed to be resumed once again. Nevertheless, after 1991, the process deteriorated further, so that today the GDP per capita of the Euro-12 is even less than 70 percent of the U.S. value.

GDP per capita (PPP) of the Euro-12 as a share of US values (1960-2014)



Source: Ameco-Data of the EU Commission

What does the US do differently?

When the US and Europe are compared in terms of their socio-economic structure, the most frequently mentioned distinguishing features are the degree of development of the welfare state and the regulation of the labor market. Beyond these structural issues there is still another crucial dimension: economic governance.

Which system is now more specific to the U.S., and which is more typically European? On one hand, the U.S. stands for limited government intervention, but on the other hand it is also known to accumulate substantial debt and to pursue a loose monetary policy. Europe is in turn associated with a commitment to a well-developed public sector and welfare state. It is also know for having the most rigid budget rules in the world, and the European Central Bank (ECB) was for years a strict guardian of price stability.

All of these traits are not contradictions. Since the 1990s an expansive economic policy, for example, has become more typical for the U.S., even though the country is considered as prevailing an economically liberal climate. To quote Flassbeck: "In the US, for example, almost all opinion leaders realized that the absence of a close-knit social network is politically viable only if economic policy and monetary policy are directly responsible for ensuring full employment. Full employment becomes the social network, so to speak, in a society in which individualism rejects direct government interventions in the living conditions of the individual."

Since the crisis began, the US has altered its economic policy much more than the Euro Zone. In 2009 the US stimulus package of 1.7 percent of GDP was much larger than the ones implemented in the EU (http://www.bruegel.org/publications/publication-detail/publication/266-estimating-the-size-of-the-european-stimulus-packages/) (in the 13 largest EU countries it represented only one percent). Overall, the budget policy in the US has been proactive. Between 2007 and 2010 the Euro-12 increased their real government spending by 10 percent, whereas the US increased its spending by 17 percent. Accordingly, the US government reported budget deficits of 13 and 12 percent in 2009 and 2010, respectively, whereas the Euro-12 reported figures that were only half of those percentages. The French finance ministry has compared the cyclically-adjusted primary deficit of the Euro Zone and the US for the years 2007-2012. The results of the comparison not only show that deficits grew much more significantly in the years 2008 and 2009, but also that consolidation in the US since 2011 has been more moderate.

Total primary structural adjustment (2008-2012)

Source: French Treasury based on Data from the IMF Fiscal Monitor

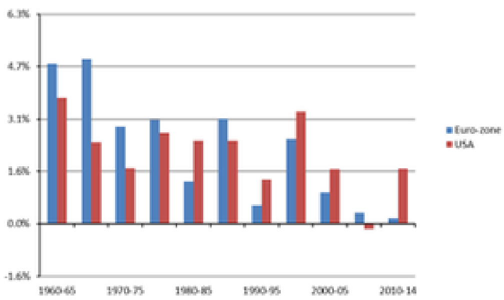
Nevertheless, the debt level in the US has not increased as much as its new borrowing levels would suggest. The ratio of public debt to GDP has risen in the US by more than 40 percentage points (to 106% of GDP), and it has increased in the Euro-12 by almost 30 percentage points (to 97% of GDP). This provides exemplary evidence that in the end a state may experience only slightly increased indebtedness levels despite engaging in much higher borrowing than a state denoting lower public deficits. This paradox of thrift explains growth that has been push started by credit-financed government spending. The advancement of completely different budget policies shows that the political will for economic governance on the other side of the Atlantic is much more pronounced than in the Euro Zone.

The US has taken a more proactive stance in the area of monetary policy. The Federal Reserve Bank has cut its base rate not only earlier and more deeply than the ECB; for most of the period this federal funds rate in the US has remained at half of the level of the Euro Zone (https://www.tresor.economie.gouv.fr/File/389023). The ECB raised its benchmark interest rate in April and July 2011 prematurely, even though the economy had not yet recovered (this measure has been subsequently reversed). Even with direct interventions by the central bank, such as through the purchase of government bonds, the ECB has been much more restrained than the Fed. In general, the ECB is trying to maintain its inflation target of two percent only if it is exceeded, and not if it falls below this target (http://www.social-europe.eu/2014/03/core-problem-ecbs-dangerous-asymmetry/) and there is a risk of deflation.

Europe's economic policy is the key to failure

In recent years, the differences in economic policy between the US and the Euro Zone in particular have come dramatically to the fore. For 20 years the US has been more flexible and pragmatic than the Euro Zone, both in terms of its budget and monetary policies. Real GDP growth in the US and the Euro-12 from 1960 to 2014 measured in five-year periods confirms the finding that the continental European economy could no longer keep up with the US by the early 1990s at the latest. This is exactly the point in time when the economic policy of the Euro Zone was mostly restrained, whereas in the US it was largely expansive.

Growth of real GDP per capita in the Euro-12 and the USA measured in 5-year periods (1960-2014)



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Source: Ameco-Data of the EU Commission

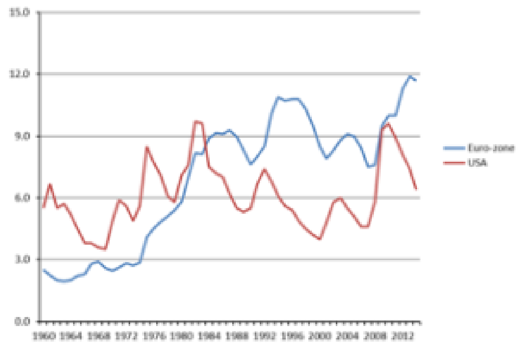
It is important to identify the priorities of the Economic and Monetary Union, which came into force in 1993 with the Maastricht Treaty, in order to understand the economic policies of the Euro Zone. The Maastricht Treaty laid down objectives in the area of monetary policy that clearly subordinated growth and employment to price stability (in the US, these goals have been given equal priority). Budget policy support is manifested in the Stability and Growth Pact, which has been strengthened in recent years by treaties such as the European Fiscal Compact. The budget rules are designed to prevent member states from becoming highly indebted, because this has been interpreted as a threat to the stability of the Euro Zone. Thus, a conservative economic policy has been closely tied to price stability and fiscal discipline. The Maastricht Treaty, which was intended to have the effect of integrating and strengthening Europe, has become the base for the fall back of the old continent.

It is difficult to seriously estimate how strong the economic impacts may be. Stockhammer has compared economic data from before and after Maastricht, and he notes not only a decline in public expenditures and budget deficits, but also in labor productivity, GDP growth and employment levels.

US treats social insecurity more seriously than in the EU

Measures to combat unemployment do not feature prominently among the objectives of European monetary and fiscal policy. Accordingly, the difference between the Euro-12 and the US is particularly apparent: Before 1984 the level of unemployment in the old Euro Zone was always below the level of the US. Since then it has exceeded US levels. While unemployment is subject to large fluctuations in the US, it does not necessarily follow a trend. In the Euro-12 it appears to be permanently increasing. Particularly striking are the developments since 2010, when the unemployment rate in both regions was still around ten percent. Since then, it has risen to nearly 12 percent in the old Euro Zone, while it is already back again this year to 6.4 percent in the US.

Development of Unemployment Rate in the Euro-12 and the USA (1960-2014)



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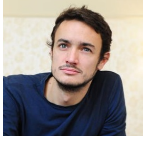
Source: Ameco- Data of the EU Commission

Nevertheless, the market liberal elites still believe that austerity and wage restraint are the only ways to save Europe's stability and competitiveness – and thus its prosperity. The more important it seems to them not to fall behind the emerging economies as well as the US, the more aggressively they propagate their agenda. Because they imagine Europe to be a company, they believe the salvation of the continent lies in waging a costs battle in world markets.

The supposed paradox now is that their policy has produced the opposite effect of what they sought to achieve – Europe is able to compete with the economic dynamism of the US less and less effectively. The exact opposite approach in fact appears more promising: Relaxation against international competition and concentration on one's own economy.

In fact, more than 80 percent of European added value is sold within the EU.

Just like in the US, the key to economic recovery lies in the (European) hinterland. A proactive economic policy is probably the most important of the many necessary steps to get the Euro Zone back on a growth track, but those who have argued for years for such a policy have not been heard.



Nikolaus works at the Macroeconomic policy institute in Düsseldorf, he is a Phd student in economics and lector at the Vienna university of economics and business. He is chairman of the social-democratic think tank Sektion 8.

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ABOUT NIKOLAS KOWALL, AUSTRIA (HTTP://OPEDSPACE.COM/AUTHOR/NIKOLAUSKOWALL/)

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