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# The Eurozone in Crisis – A Kaleckian Macroeconomic Regime and Policy Perspective

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# 1. Introduction

- Covid-19 Crisis has hit the Eurozone asymmetrically, while it was already in a fragile situation due to insufficient recovery from Great Financial Crisis, Great Recession & Eurozone Crisis
- Severe problems of economic policy institutions and the economic policy model based on NCM
- First, in 'normal' times there were no mechanisms that prevented rising current account imbalances and divergence among member states.
- Second, in the Eurozone crisis, it became clear that nominal interest rate policies of the ECB were insufficient to stabilise aggregate demand and economic activity.
- Third, and the main reason for the Eurozone Crisis, the role of the ECB as a 'lender of last resort', not only for the banking sector, but also for member state governments, was unclear at the beginning of the crisis and has only partly been remedied since then.

- The initial responses towards the Covid-19 Crisis in 2020 in the EU and the Eurozone have been quite expansionary
- Fiscal policies: strict budgetary rules have been temporarily suspended and discretionary fiscal expansion of more than 3.5 per cent of EU GDP has been implemented at national and EU levels, associated with liquidity guarantees of more than 25 per cent of EU GDP (European Commission 2020a).
- New assistance schemes (EU funding for short-term work scheme); and existing institutions have been targeted towards fighting the crisis (ESM pandemic crisis support, EIB financing for business) (European Commission 2020b).
- European Commission (2020c) has presented a recovery plan with expenditures of € 750 billion over several years, financed by debt issued by the European Commission.
- ECB (2020) has announced further expansionary measures (supporting commercial banks with longer-term refinancing operations at negative interest rates, stabilising financial markets with the continuation of its asset purchase programme (APP) and a new pandemic emergency purchase programme (PEPP) and kept main refinancing interest rate at zero percent (with a corridor of -0.5 to 0.25 percent given by the deposit and the marginal lending facility rates).

- Change in long-run macroeconomic policy stance or just short-run ad hoc responses to a deep crisis?
- Move towards a policy model with an active role for fiscal policies beyond the short run is required in order to stabilise the Eurozone economies in the short run and to deal with inadequate employment performance, asymmetries and imbalances, in the medium to long run.
- Alternative policy approach can build on the contributions by Michał Kalecki, particularly those from the 1940s, which have been further developed in modern post-Keynesian macroeconomics.

# **1. Introduction**

## **2. Demand and growth regimes in the Eurozone**

### **2.1 Demand and growth regimes in finance-dominated capitalism**

### **2.2 Demand regimes and imbalances within the Eurozone 2001-09**

### **2.3 Demand regimes, 'rebalancing' and stagnation à la Eurozone 2010-2019**

## **3. Kalecki's economic policy suggestions for achieving and maintaining full employment**

## **4. A Kaleckian/post-Keynesian policy mix for the Eurozone**

## **5. Conclusions**

## **2. Demand and growth regimes in the Eurozone**

## 2.1 Demand and growth regimes in finance-dominated capitalism

- Financialisation has had important implications for (1) income distribution, (2) investment in capital stock, (3) consumption and (4) the build-up of global and regional (European) current account imbalances (Hein 2012).
- Depressive effects on income-financed consumption via re-distribution and on investment via shareholder value orientation.
- Compensation: credit-financed consumption (hh debt) or net exports (foreign debt)
- Regimes: (1) a debt-led private demand boom regime, (2) an export-led mercantilist regime, (3) a weakly export-led regime and (4) a domestic demand-led regime

## 2.2 Demand regimes and imbalances within the Eurozone 2001-09

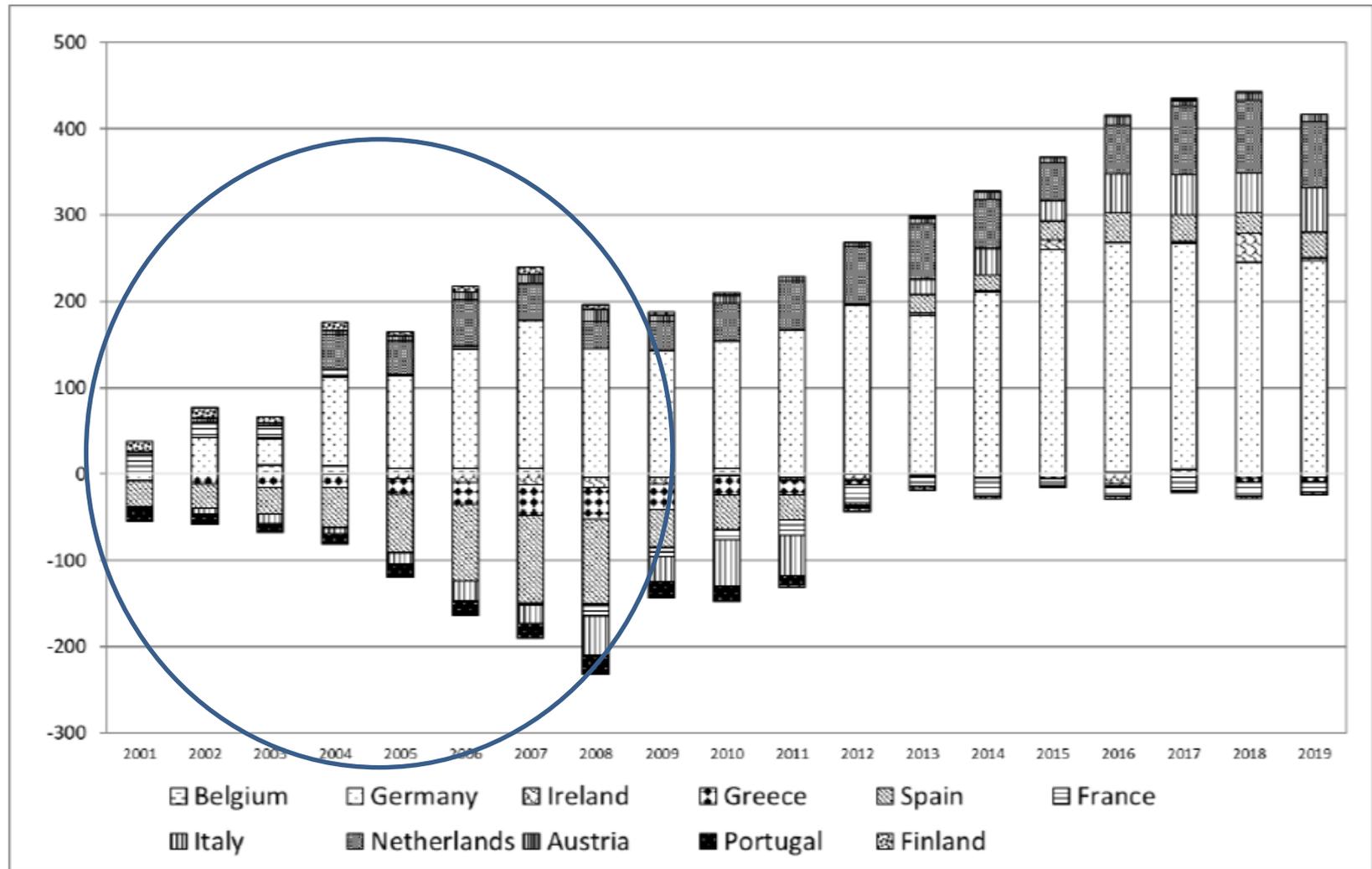
**Table 1.** Key macroeconomic variables for the economies of the core Eurozone, average annual values for the period 2001-2009

	Export-led mercantilist				Weakly export-led	Domestic demand-led				Debt-led private demand boom		
	Austria	Belgium	Germany	Netherlands		Finland	France	Italy	Portugal	EA-12	Greece	Ireland
Financial balances of external sector as a share of nominal GDP, per cent	-2.05	-4.20	-4.00	-5.55	-4.91	-0.42	1.04	7.96	-0.63	10.08	2.60	5.61
Financial balances of public sector as a share of nominal GDP, per cent	-2.43	-1.21	-2.44	-1.43	3.01	-3.45	-3.28	-5.19	-2.63	-8.03	-1.58	-1.32
Financial balances of private sector as a share of nominal GDP, per cent	4.47	5.40	6.43	6.98	1.90	3.87	2.24	-2.77	3.22	-2.04	-3.23	-4.29
– Financial balance of private household sector as a share of nominal GDP, per cent	4.87	4.58	5.52	-1.39	-2.32	2.78	2.47	2.00	2.21	-6.77	-6.06	-2.73
– Financial balance of the corporate sector as a share of nominal GDP, per cent	-0.40	0.82	0.91	8.36	4.21	1.08	-0.23	-4.77	1.01	4.73	2.83	-1.56
Real GDP growth, per cent	1.52	1.60	0.53	1.39	1.68	1.19	0.18	0.63	1.04	2.04	3.05	2.36
Growth contribution of domestic demand including stocks, percentage points	1.16	1.44	0.02	1.21	1.60	1.43	0.36	0.51	0.96	2.96	2.66	2.61
– Growth contribution of private consumption, percentage points	0.79	0.60	0.19	0.30	1.23	0.97	0.23	0.64	0.62	2.09	1.49	1.34
– Growth contribution of public consumption, percentage points	0.34	0.42	0.25	0.78	0.35	0.38	0.22	0.38	0.40	0.66	0.62	0.87
– Growth contribution of gross fixed capital formation, percentage points	0.02	0.38	-0.18	0.19	0.22	0.24	0.00	-0.40	0.09	0.59	0.69	0.47
Growth contribution of the balance of goods and services, percentage points	0.35	0.18	0.51	0.17	-0.10	-0.20	-0.18	0.07	0.09	-0.31	0.87	-0.25
Net exports of goods and services as a share of nominal GDP, per cent	3.34	3.85	4.81	7.56	5.52	0.35	0.05	-8.14	1.82	-10.44	12.40	-3.56

Source: European Commission (2019), authors' calculations.

# Regional current account imbalances

Figure 1. Current account balance in core Eurozone countries, 2001-2019 (in bn euros)

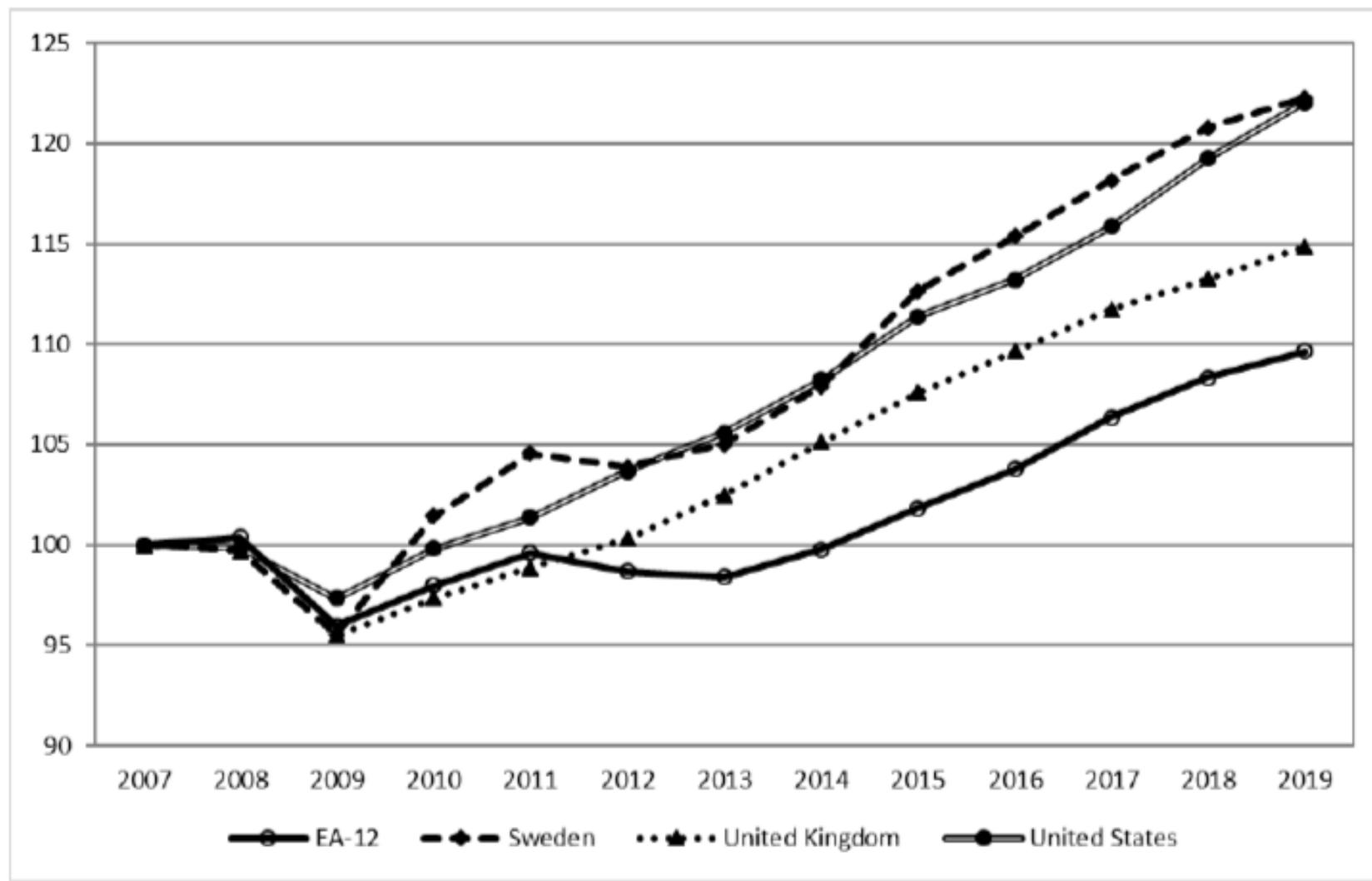


Source: European Commission (2019), authors' representation.

## 2.3 Demand regimes, 'rebalancing' and stagnation à la Eurozone 2010-2019

- The restrictive economic policy responses towards the Eurozone crisis have contributed to another recession in the EA-12 in 2012/13 and to a weak recovery in international comparison (Figure 2).
- EA-12 growth has been lagging behind other non-Eurozone developed capitalist economies, for which the recovery has also been weak in historical perspective → 'secular stagnation' (Summers)
- Asymmetric recovery: Germany et al. vs. periphery
- In particular, growth contributions of investment, which had been very modest already in the period 2001-09, even declined on average over the period 2010-19, turning negative in some countries (Spain, Italy, Greece, Portugal) (Table 2).
- Financial balances of the corporate sectors turned positive in all the countries we are examining. Corporate saving thus exceeded corporate investment – a phenomenon of finance-dominated capitalism (Hein 2012, Chapter 3), which dominated even in the first period in several Eurozone countries.

**Figure 2.** Real GDP in selected OECD countries and the Eurozone (EA-12), 2007-2019, 2007 = 100



Source: European Commission (2019), authors' representation.

# Shift of regimes towards export-led mercantilist

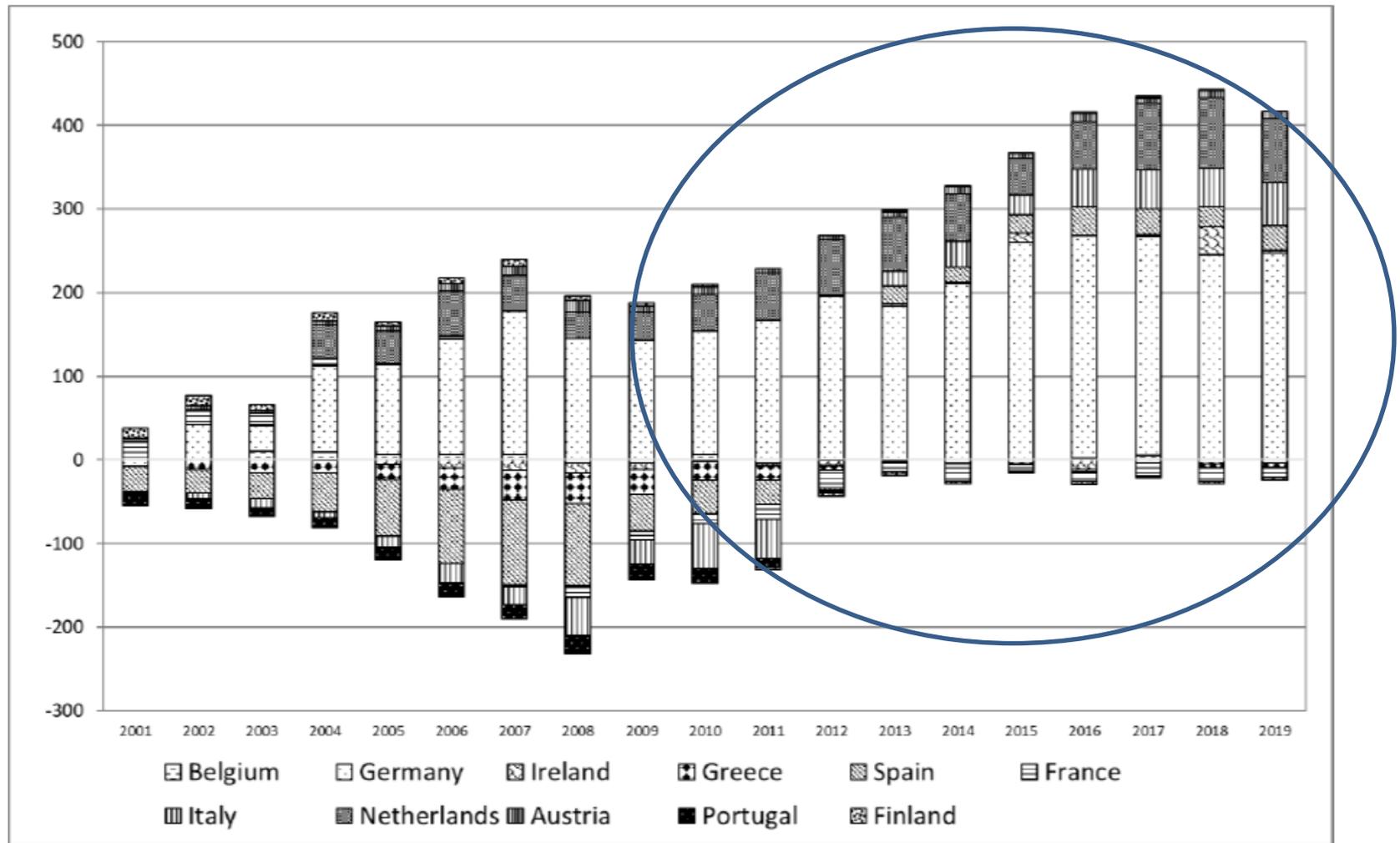
**Table 2.** Key macroeconomic variables for the economies of the core Eurozone, average annual values for the period 2010-2019

	Export-led mercantilist							Weakly export-led			Domestic demand-led	
	Ireland	Spain	Austria	Germany	Netherlands	Italy	EA-12	Belgium	Greece	Portugal	France	Finland
Financial balances of external sector as a share of nominal GDP, per cent	3.77	-1.41	-2.15	-7.24	-8.82	-0.94	-2.75	-0.76	1.74	0.20	0.81	1.08
Financial balances of public sector as a share of nominal GDP, per cent	-6.55	-6.03	-1.65	0.18	-1.65	-2.83	-2.53	-2.69	-4.92	-4.76	-4.06	-1.80
Financial balances of private sector as a share of nominal GDP, per cent	3.88	7.44	3.80	7.05	10.46	3.77	5.31	3.44	3.18	4.56	3.25	0.72
– Financial balance of private household sector as a share of nominal GDP, per cent	1.77	0.89	2.50	5.27	2.80	1.24	2.77	1.90	-5.53	2.68	3.09	-2.83
– Financial balance of the corporate sector as a share of nominal GDP, per cent	2.10	6.55	1.31	1.78	7.66	2.53	2.54	1.55	8.72	1.88	0.16	3.55
Real GDP growth, per cent	6.31	1.03	1.57	1.96	1.45	0.22	1.34	1.54	-1.98	0.76	1.35	1.23
Growth contribution of domestic demand including stocks, percentage points	3.62	0.34	1.25	1.74	0.92	-0.16	1.01	1.57	-3.01	0.25	1.36	1.61
– Growth contribution of private consumption, percentage points	0.64	0.27	0.49	0.73	0.33	0.05	0.43	0.79	-1.67	0.44	0.55	0.75
– Growth contribution of public consumption, percentage points	0.12	0.04	0.14	0.38	0.13	-0.09	0.18	0.1	-0.52	-0.17	0.29	0.18
– Growth contribution of gross fixed capital formation, percentage points	2.65	-0.05	0.53	0.56	0.36	-0.12	0.32	0.57	-1.16	-0.11	0.39	0.37
Growth contribution of the balance of goods and services, percentage points	3.10	0.69	0.20	0.21	0.53	0.39	0.34	-0.03	1.03	0.50	-0.01	-0.26
Net exports of goods and services as a share of nominal GDP, per cent	21.38	2.48	3.33	6.25	9.73	1.78	3.53	0.71	-2.75	-0.88	-1.03	-0.65

Source: European Commission (2019), authors' calculations

# Rebalancing a la Eurozone

Figure 1. Current account balance in core Eurozone countries, 2001-2019 (in bn euros)



Source: European Commission (2019), authors' representation.

- Shift towards export-led mercantilism of previous debt-led private demand boom and domestic demand-led countries was enforced by deleveraging and austerity policies
- EA-12 as a whole has turned export-led mercantilist
- Internal current account imbalances have been externalised; Eurozone as a free rider of aggregate demand generated in the rest of the world, contributing to global imbalances and instabilities
- Weak and unbalanced recovery requires return towards a domestic demand-led regime, which will need an alternative approach towards macroeconomic management and policies.

### **3. Kalecki's economic policy suggestions for achieving and maintaining full employment**

## Kalecki's (1933 ff) principle of effective demand

- Distribution matters, profit share determined by mark-up pricing on constant unit variable costs
- Excess capacity, changes in demand trigger changes in capacity utilisation
- Investment can be initially financed by credit and generates the respective amount of saving for final finance,
- Investment is determined by expected demand and internal means of finance (principle of increasing risk)
- Paradox of thrift
- Equilibrium domestic demand is wage-led
- Government deficit expenditures as well as export surpluses raise equilibrium aggregate demand and the volume of profits

## 'Three ways to full employment' Kalecki (1944)

1. Government deficit spending on public investment (schools, hospitals, highways) or on subsidies to mass consumption (family allowances, reduction of indirect taxes, subsidies to keep down prices of necessities).
  2. Stimulating private investment through reductions in the interest rate or through lowering income taxes.
  3. Redistribution of income from higher to lower income classes
- Second way is discarded, because immediate effect is uncertain (depressed expectations), and if successful, capacity effect of investment will require further interest and/or tax cuts.
  - Kalecki (1944) proposes a combination of the first and the third way, i.e. government deficit spending and progressive income re-distribution

- Regarding government deficit spending, Kalecki (1944) explains that there will not be any crowding out if there are unemployed resources and if interest rates are kept low.
- First, any initial deficit will partly finance itself through higher incomes and higher tax revenues.
- Second, also the remaining budget deficit will finance itself, too, because it generates additional saving of an equal amount through the income effect.

$$G + I + C_{\Pi} + C_W = T_{\Pi} + \Pi + T_W + W = T_{\Pi} + C_{\Pi} + S_{\Pi} + T_W + C_W + S_W$$

$$S = I + G - T$$

- ‘(W)hatever is the general economic situation, whatever the level of prices, wages or the rate of interest, any level of private investment and Budget deficit will always produce an equal amount of saving to finance these two items.’ (Kalecki 1944, p. 41)

- If this additional saving by the private sector is not creating demand for government bonds but rather for liquidity, imposing upward pressure on interest rates in government bonds markets, central banks have to step in and prevent interest rates from rising.
- ‘... the rate of interest may be maintained at a stable level however large the Budget deficit, given proper banking policy’ (Kalecki 1944, p. 42)
- Kalecki (1944) argues that national debt cannot be a burden to society as a whole, because it only constitutes internal transfers between those holding government debt and those paying taxes.
- Interest rates below growth rate do not require taxes to take care of interest payments
- If taxes are to finance interest payments, Kalecki proposes taxes on wealth, both on financial and real assets, equivalent to the interest payments of the government

- Government deficit expenditures find a limit when scarcity of labour and/or capital stock will emerge and a full employment or full utilisation inflation barrier is reached:
- ‘In order to avoid inflation the Government must, therefore, be careful not to push their deficit spending beyond the mark indicated by full utilization of labour and equipment.’ (Kalecki 1944, p. 43)
- If the capital stock is too low for full employment, as it may occur in backward countries, the focus of government activities should also be on expanding productive capacities.
- When full employment is reached, nominal wages should not rise faster than productivity, in order to avoid rising inflation. Real wages should thus rise with labour productivity.
- Government deficit spending within the outlined limits will also stabilise private investment and prevent violent cyclical fluctuations. Besides, private investment should be regulated by tax rates with the following target:
- ‘Private investment must be at a level adequate to expand the capacity of equipment pari passu with the increase in working population and productivity of labour, i.e. proportionately to full employment output.’ (Kalecki 1944, p. 47)
- Regarding the type of government expenditure, Kalecki (1944) argues that it should be guided by social priorities and hence not exclusively be focused on public investment, but also include public consumption and subsidies to private consumption.

- Government deficit expenditure should be complemented by the third way to full employment, the redistribution of income, shifting income to low income households with a higher propensity to consume.
- For this purpose, he advocates progressive taxation. In order to avoid negative effects on investment, he proposes a 'modified income tax', exempting re-invested profits from (progressive) taxation (Kalecki 1943a) or a wealth tax on financial and real assets.
- Furthermore, redistribution can be achieved by real wages growing faster than productivity, or nominal wage growth exceeding productivity growth plus the inflation rate.
- At full employment, however, attempting re-distribution by wage policies would require higher taxes on profit income in order to prevent inflation due to excess demand. Alternatively, or in combination with tax increases, Kalecki suggests price controls in order to squeeze profits when wages are rising.

## ‘Political aspects of full employment’ (Kalecki (1943a):

- potential resistance from ‘economic experts’ closely connected with banking and industry against full employment policy, although higher government deficits raise capitalists profits after taxes:  $\Pi = I + C_{\Pi} + G - T - S_w$
- ‘The reasons for the opposition of ‘industrial leaders’ to full employment achieved by government spending may be subdivided into three categories: (i) dislike of government interference in the problem of employment as such; (ii) dislike of the direction of government spending (public investment and subsidizing consumption), (iii) dislike of the social and political changes resulting from the *maintenance* of full employment.’ (Kalecki 1943b, pp. 349-350, emphasis in the original)
- Kalecki (1943a) concedes that in post-war economies, or in deep recessions, governments’ responsibility for full employment may be acknowledged, also by capitalists and their ‘experts’.
- First, capitalists would prefer indirect stimuli for private investment (interest rate and tax cuts) over government expenditure. And if government expenditure is accepted, the focus should be on investment, not subsidizing consumption.
- Second, capitalists would insist that measures should be confined to the slump and would resist permanent public deficit spending to sustain full employment.
- ‘stop and go policy’ and ‘political business cycle’

- Full employment capitalism will have to develop new social and political institutions which reflect the increased power of the working class and requires ‘fundamental reform’.
- Kowalik (2004, p. 48): ‘Kalecki would most probably say, that the essence of “crucial reform” was successful governance of overall demand’.
- When the ‘crucial reform’ is reversed, as in the late 1970s, early 1980s, with the liberalization of labour and financial markets and the monetarist turn of macroeconomic policies, stagnation tendencies and high unemployment are back on the agenda – and they have stayed since then.
- Extending Kalecki’s (1943a) notion of a ‘political business cycle’, Steindl (1979) then called this ‘stagnation policy’ or ‘stagnation as a political trend’.

## **4. A Kaleckian/post-Keynesian policy mix for the Eurozone**

- Kalecki's full employment policy proposal from the 1940s implies a macroeconomic policy mix, which has inspired modern post-Keynesian macroeconomics.
- Coordinated macroeconomic policies in line with Kalecki (1944) overcoming problems of NCM in Eurozone:
  - „Functional finance“ fiscal policy to generate and stabilise full employment, accompanied by progressive taxation for distributional and stabilisation purposes (automatic stabilisers)
  - Monetary policy guaranteeing public debt of member countries and targeting low long-term interest rates, also taking care of financial stability with other instruments (collateral standards, reserve requirements, credit controls)
  - Wage/incomes policies providing stable inflation at full employment (with some effects on income re-distribution)
  - Industrial and regional policies to overcome supply side, i.e. capital stock and human capacities, constraints.

Coordination is required: 'policy package'

- Vertical coordination of national, as well as European institution within the respective policy area
- Horizontal coordination among areas of policy making at national and European levels,

➤ Aggregate demand management

➤ Industrial and regional development strategy

➤ Making use of current institutions: Macroeconomic Dialogue, European Semester, financing institutions for regional and industrial policies (EIB, EIF), and new institutions developed as response towards Covid 19 crisis.

## Fiscal policy

Focus on real stabilisation, full employment, a more equal distribution of disposable income, and improving supply side through public investment, taking into account a balanced current account target:

$$(4) \quad S - I = X - M + G - T .$$

With a balanced current accounts government, deficits in the long-run perspective (D) have to permanently take up the excess of private saving over private investment (Kalecki 1944, Lerner 1943):

$$(5) \quad D = G - T = S - I .$$

Following Domar (1944) and Kalecki (1944):

$$(6) \quad \frac{B}{Y^n} = \frac{D}{\hat{Y}^n}$$

$$(7) \quad \frac{B}{Y^n} = \frac{D'}{\hat{Y}^n - i}$$

Permanent government deficits + short-run stabilisation in case of cyclical shocks:

$$(8) \quad D = D_L + D_S (Y^T - Y), \quad D_S > 0 .$$

Progressive income taxes, relevant wealth, property and inheritance taxes, as well as social transfers reduce excess saving and improve automatic stabilisers.

- Coordination of long-run expenditure paths for non-cyclical government spending in order to generate a long-run ‘structural’ government deficit/surplus balancing the long-run ‘structural’ private sector surplus/deficit at high levels of non-inflationary employment and a roughly balanced current account
- Expenditure paths should be coordinated and monitored by the European Commission
- ECB keeping nominal interest rates in each country below trend nominal GDP growth of the respective country, will make sure that debt services will not have restrictive distributional effects
- Coordination of national fiscal policies, together with efforts at the EU level should contribute to overcoming the Covid-19 Crisis.
- It should also boost aggregate domestic demand for the Eurozone as a whole in the medium to long run, contribute to overcoming the export-led mercantilist regime and the long-run stagnation tendencies by stimulating also private investment and domestic demand.

## European industrial and regional policy

- Required for catching up without reappearance or excessive imbalances → improvement of non-price competitiveness
- Growth differentials incur tendencies towards current account imbalances
- CA deficits and surpluses related to catching up should be tolerated by coordinated fiscal policies, i.e. government deficits in CA surplus countries can be lower in CA deficit countries can be higher
- Criterion for acceptable CA deficits: growth of deficit country is sustainable, exceeds average growth of surplus countries, and also the long-term interest rate.

- Therefore:
- prevent unsustainable credit-driven bubbles and private demand booms → regulation
- capital inflows should be focused on productivity enhancing investment and the development of export capacities  
→ role for EIB, EIF etc.
- and they should be integrated into a European regional and industrial development strategy of ecological modernisation – like the European Green Deal.

## Monetary policy

- Continue targeting low real long-term interest rates
- contribute to financial stability: credit standards, reserve requirements, credit controls
- most important: lender of last resort for the banking system but also for Eurozone member countries

ECB announcement: intervention into secondary government bond markets as soon as the rate of interest on government bonds exceeds the long-run nominal rate of growth of the respective country

⇒ country specific cap on government bond yields:

$$(9) \quad \hat{p}_j \leq i_j \leq \hat{Y}_j + \hat{p}_j.$$

## Wage and incomes policy

- Contribute to stabilising income shares and inflation at Eurozone target rate

$$(10) \quad \hat{w}_j = \hat{y}_j + p^T,$$

- Abandon the dominating policies of labour market flexibilisation and of gaining competitiveness by means of nominal wage restraints (cuts)
- Re-regulation of labour market, stabilisation of labour unions and employer associations
- legal extension of wage bargaining agreements
- Euro-area wide minimum wage legislation
- increase minimum wage by inflation target plus national productivity growth each year

## 5. Conclusions

- Covid-19 Crisis has hit the Eurozone in a highly fragile situation, with a weak and asymmetric recovery from the Great Financial Crisis, the Great Recession and the following Eurozone Crisis.
- These crises have also revealed the weaknesses of the macroeconomic policy institutions and strategies of the Eurozone based on the NCM
- Weaknesses and the fragilities become obvious in the the demand and growth regimes of EA-12 countries, up to and then in the course and after the Eurozone crisis
- Internal imbalances within the EA-12 in the first period, with the polarization of current account deficit debt-led private demand boom countries, on the one hand, and of current account surplus export-led mercantilist countries, on the other hand, have been externalized in the second period.
- Most of the countries of the core Eurozone and the EA-12 as a whole have now turned export-led mercantilist.
- The EA-12 has thus not only seen a weak recovery from the previous crises in international comparison, it has also contributed to sustained global current account imbalances, and it is highly vulnerable with respect to turbulences of world demand

- Alternative to NCM and export-led mercantilist regime can be found in Kalecki's full employment policy suggestions: government deficit expenditures, in combination with re-distribution policies in favour of labour and low-income households, assisted by central banks targeting low interest rates.
- We have outlined such a policy mix of functional finance fiscal policy, low interest rate targeting monetary policy and inflation stabilising wage/incomes policies, linked with regional and industrial policies to improve sustainable catching up for the Eurozone.
- This policy should contribute to a more rapid recovery from the Covid-19 Crisis and to a medium- to long-run non-inflationary full employment domestic demand-led regime, on the one hand, and to sustainable catching-up of the periphery of the Eurozone with respect to the more mature center, on the other hand.
- Whether the implementation of such a policy mix would be equivalent to a 'crucial reform' in the sense of Kalecki and Kowalik (1971) may need further discussion

**THANK YOU**