Stagnation policy in the Eurozone and economic policy alternatives:
A Steindlian/neo-Kaleckian perspective

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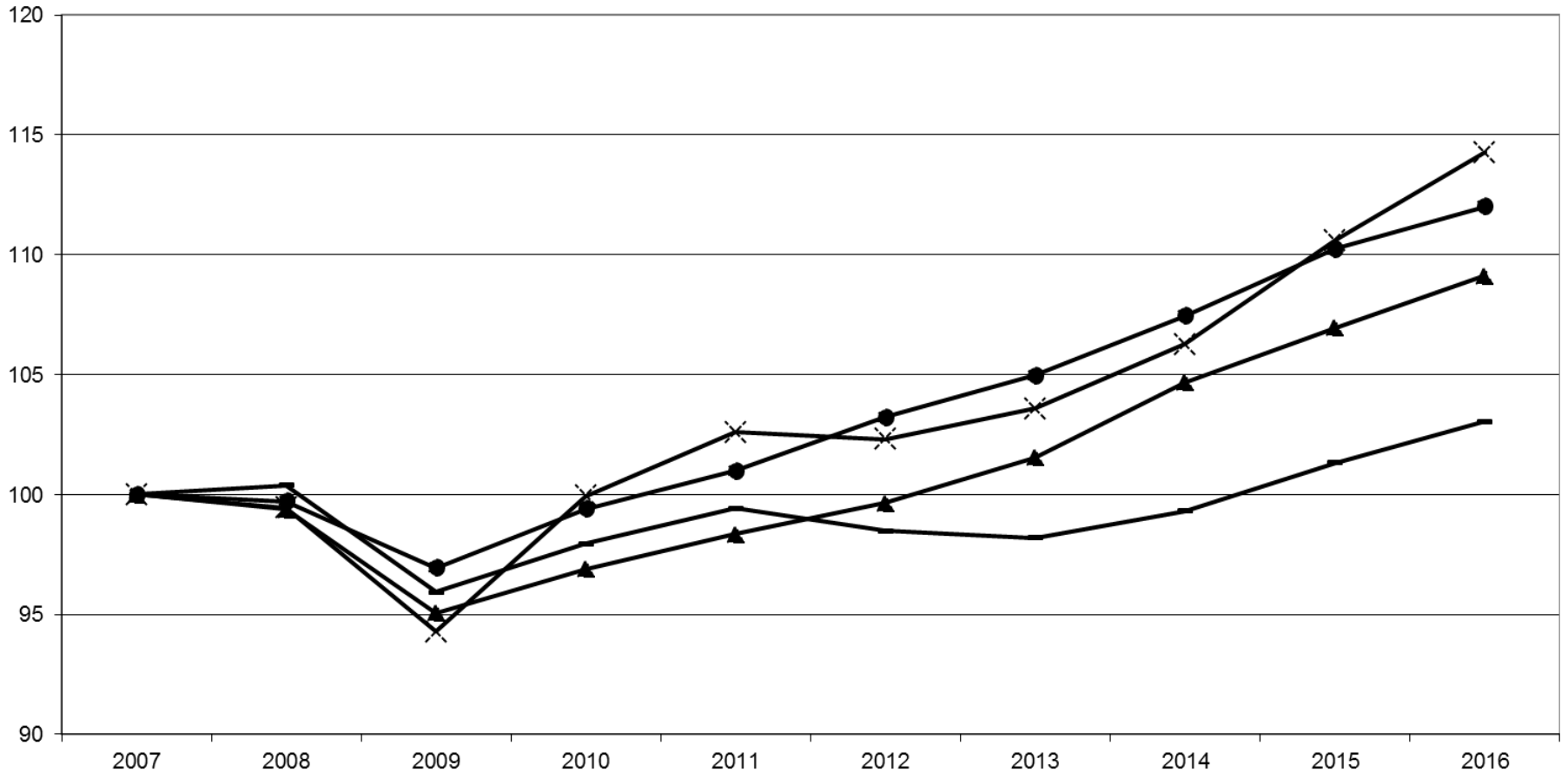**Visiting Professor Sapienza University Rome**

Centro Sraffa, University Rome III

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Eurozone recovery particularly weak …

Figure 1: Real GDP in the Eurozone (EA-12), the USA, the UK and Sweden, 2007-2016, 2007=100

Several Eurozone countries still under water …

Figure 2: Real GDP in Eurozone member countries, 2007-2016, 2007=100

Legend: Belgium, Germany, Ireland, Greece, Spain, France, Italy, Netherlands, Austria, Portugal, Finland

Some stabilisation of Eurozone income distribution …

Figure 3: Labour income share in the Eurozone (EA-12), the USA, the UK an Sweden, as percentage of GDP at current factor cost, 1991-2016

Legend: Euro area (12 countries) — Sweden — UK — USA

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... but LIS still falling in crisis countries: Greece, Spain, Portugal, Italy, ...

Figure 4: Labour income share in Eurozone member countries, percentage of GDP at current factor cost, 1991-2016
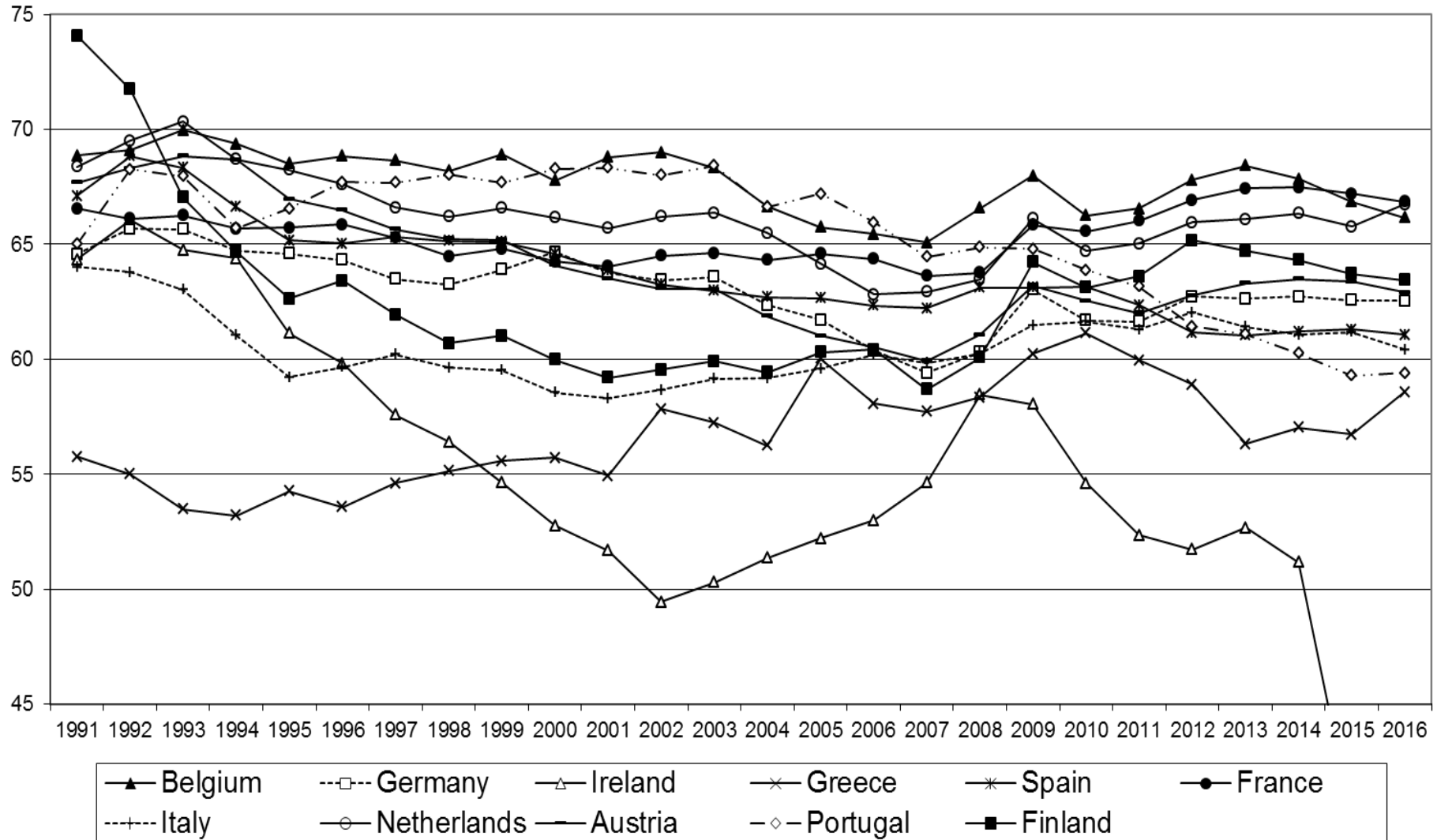
Eurozone fiscal austerity policies …

Figure 5: General government financial balance relative to GDP in the Eurozone (EA-12) , the USA, the UK and Sweden, in per cent, 1995-2016

Legend: ─── Euro area (12 countries)　─✕─ Sweden　─▲─ UK　─●─ USA

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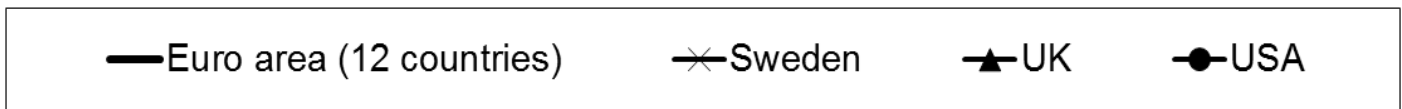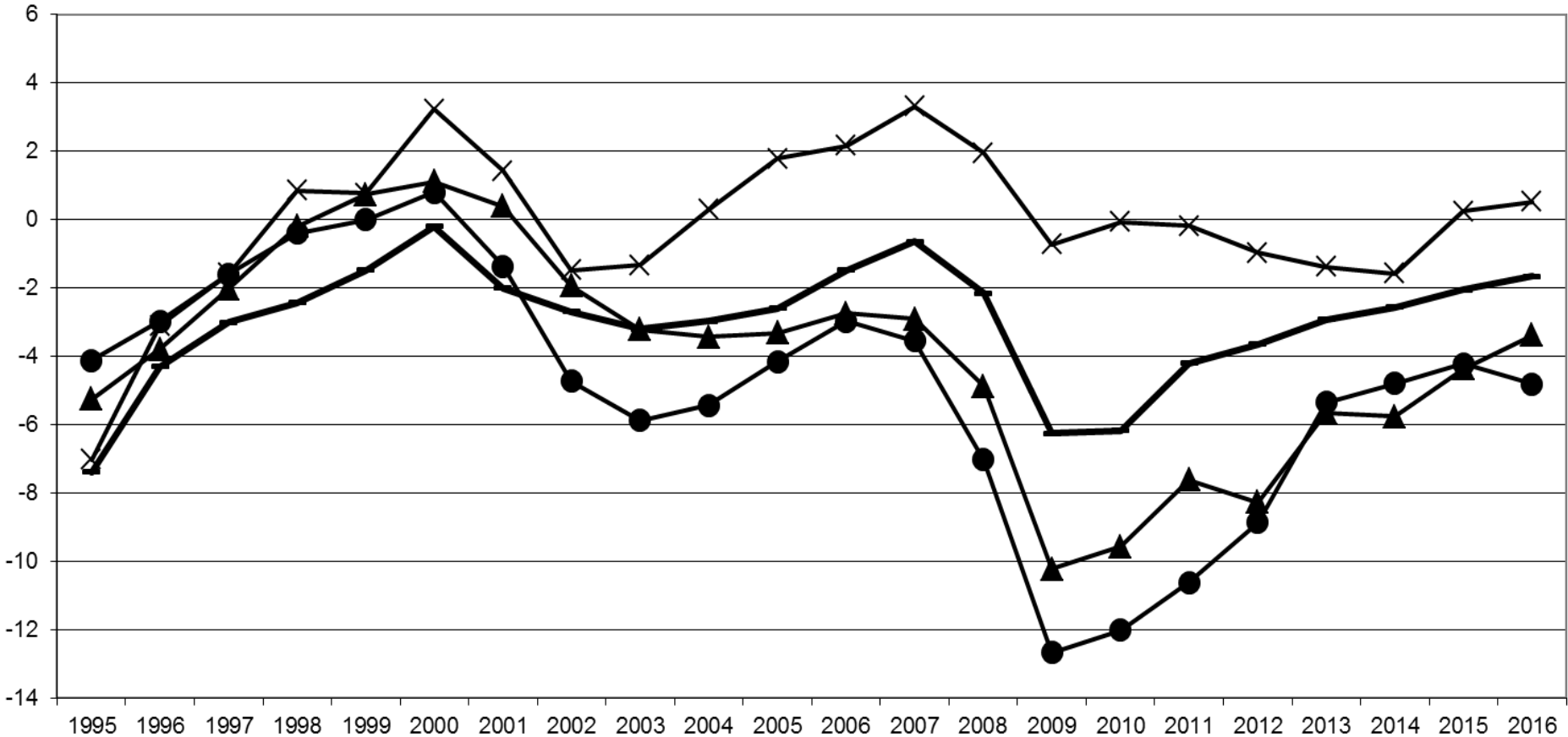
Figure 6: General government financial balance relative to GDP in Eurozone member countries, in per cent, 1995-2016

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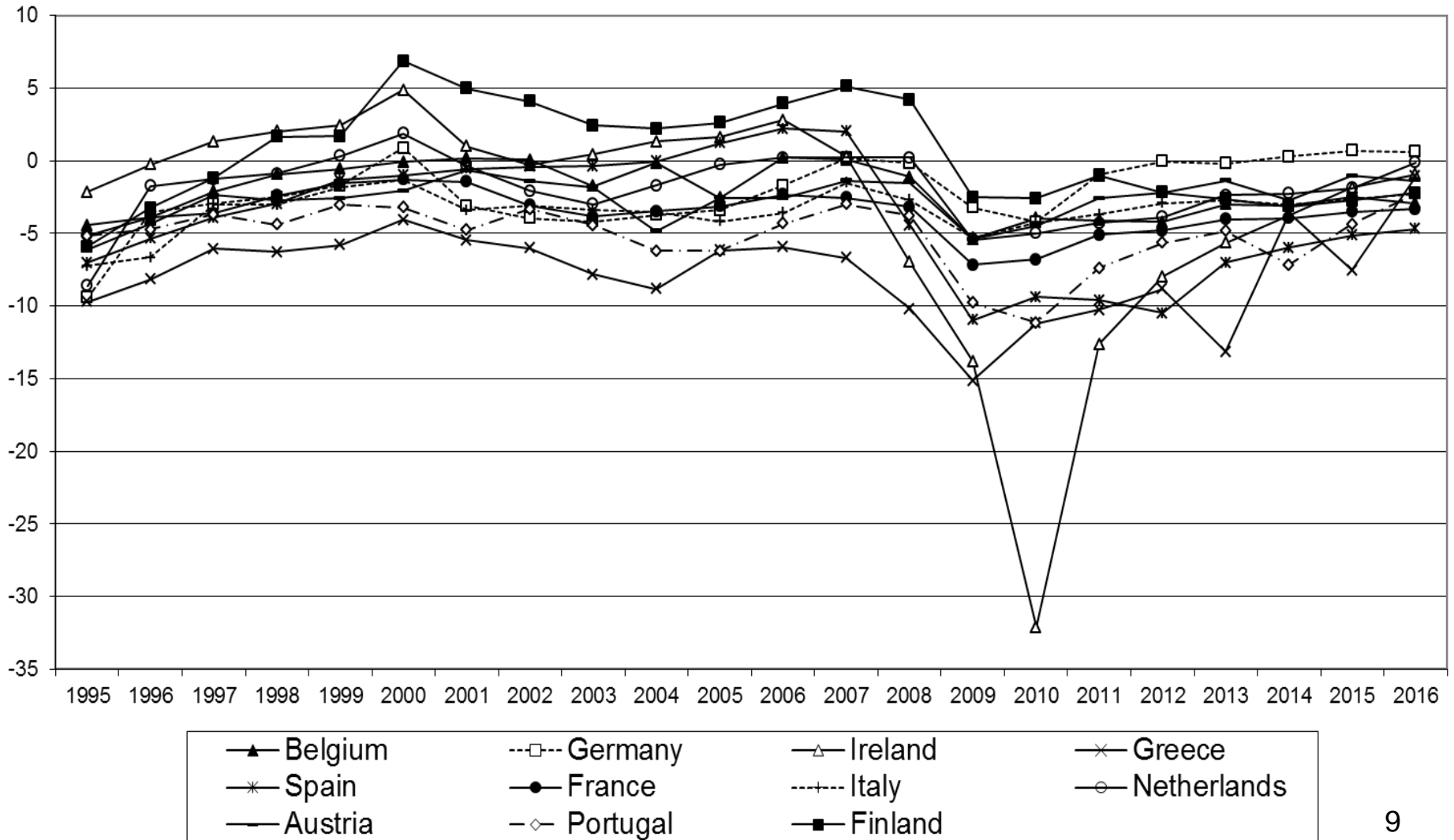
No general reduction of the government debt-GDP ratios …

Figure 7: General government gross consolidated debt relative to GDP in the Eurozone (EA-12) , the USA, the UK and Sweden, in percent, 1995-2016
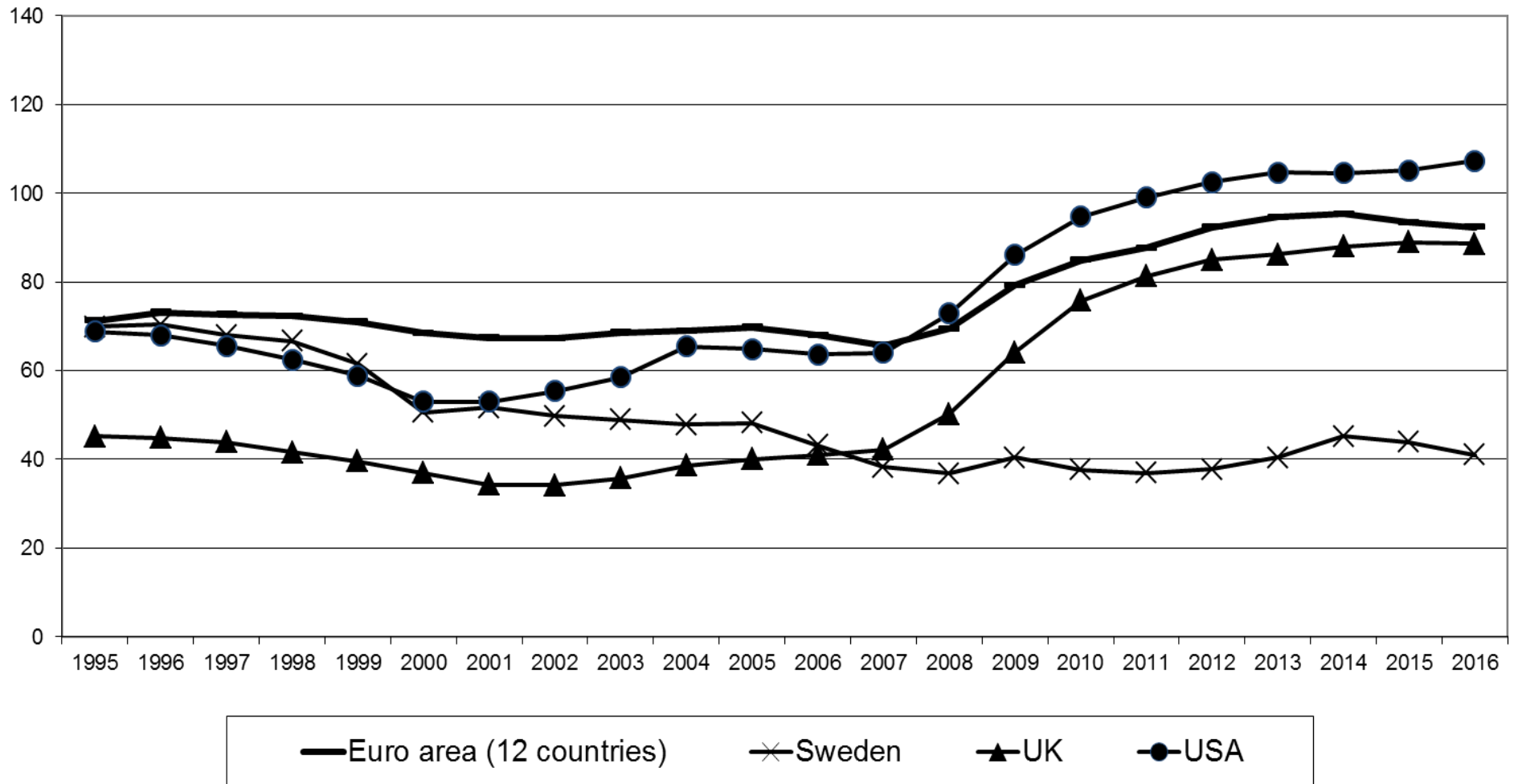
Figure 9: General government gross consolidated debt relative to GDP in Eurozone member countries, in percent, 1995-2016

Current account defcits tend to disappear – but surpluses remain
→ Eurozone as a free rider of world demand

CA surplus of EA12: 0.5 % GDP in 2010, 3.6 % of GDP in 2016

Figure 9: Current account in billions ECU/euro, selected Eurozone countries, 1995 – 2016
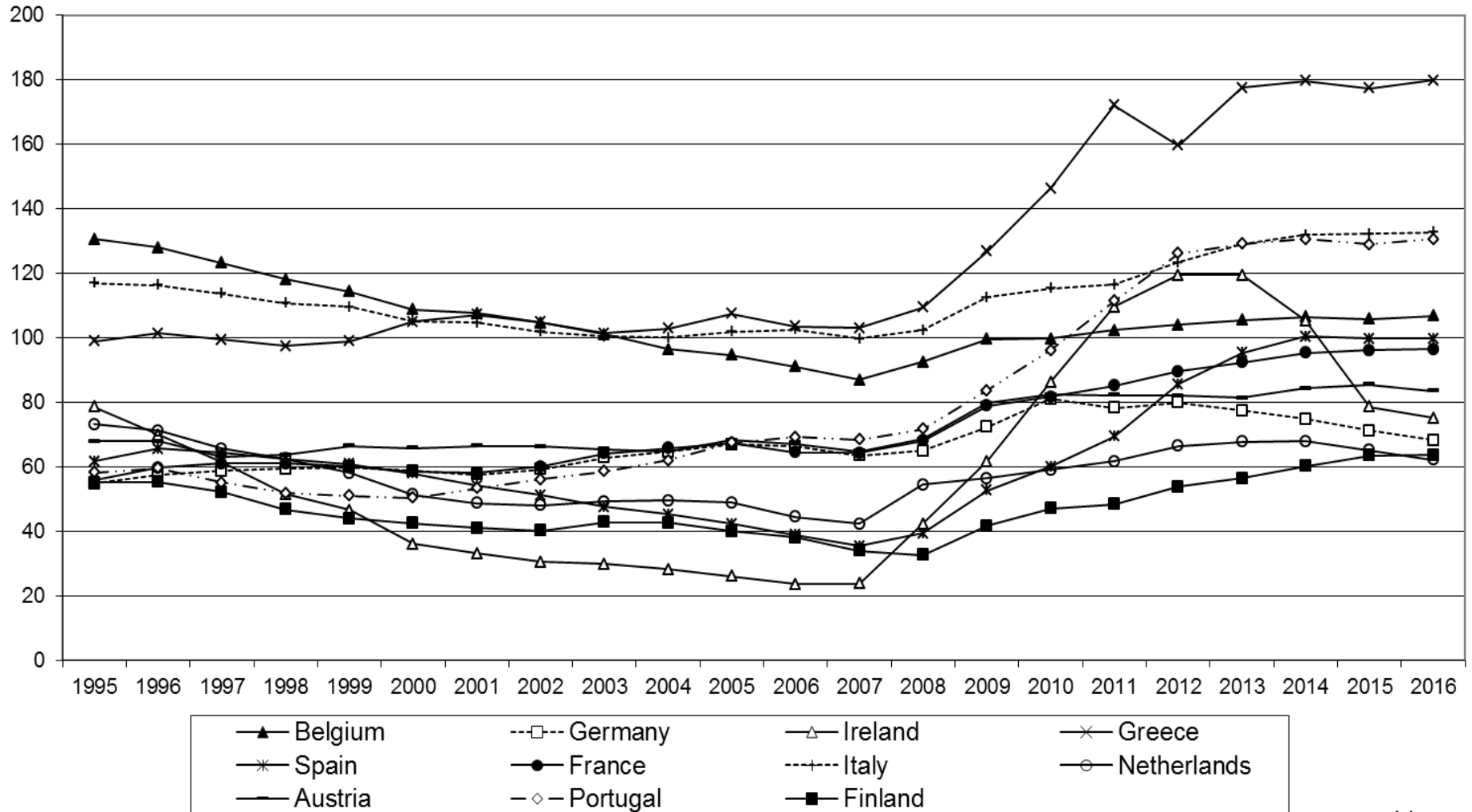
Eurozone driven by foreign demand and deficits …

Figure 10: Eurozone (EA-12): Sectoral financial balances as a percentage share of nominal GDP, 1995 - 2016
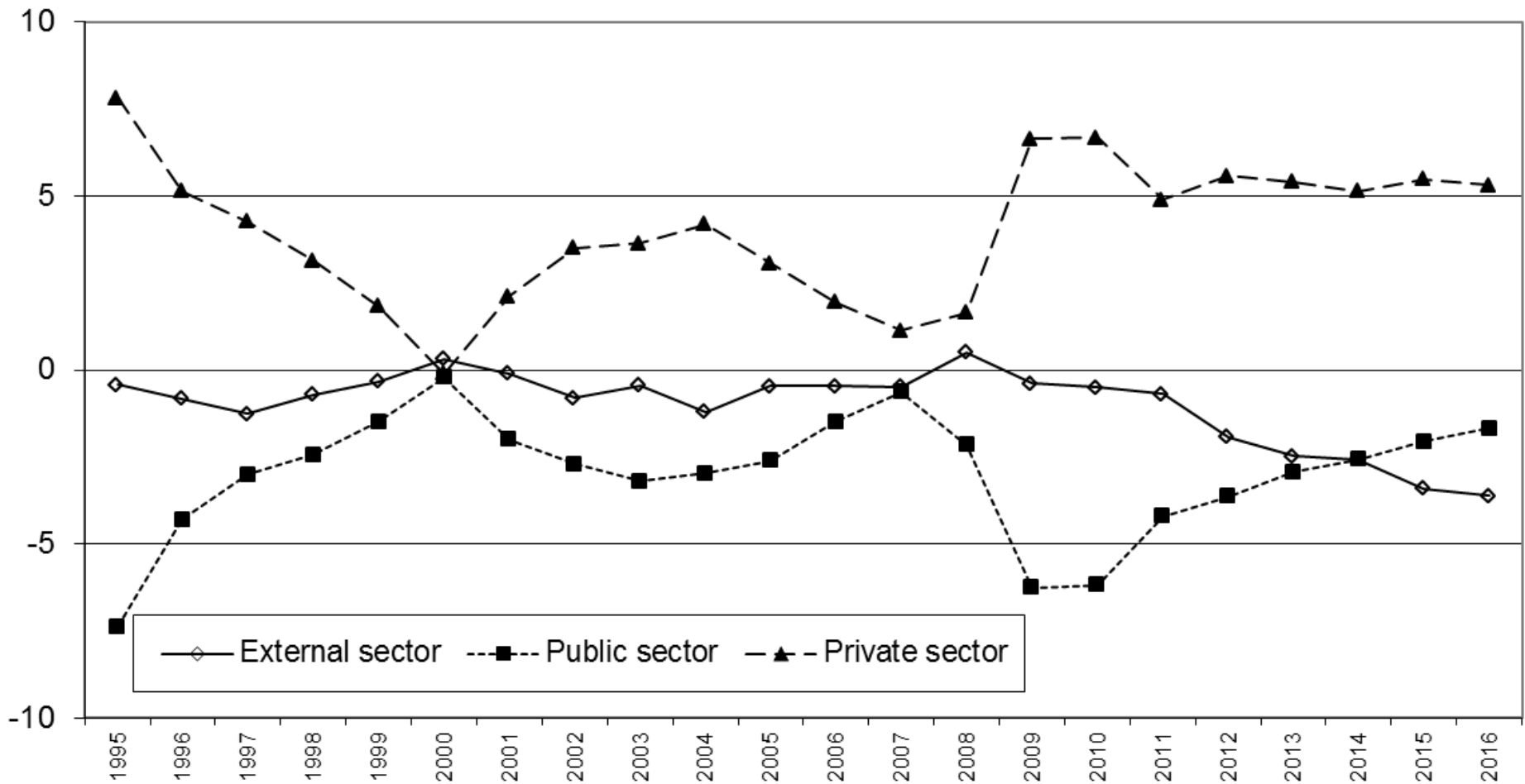
Eurozone as enlarged Germany

Figure 11: Germany: Sectoral financial balances as a percentage share of nominal GDP, 1995 - 2016

… similar to small open Swedish economy …

Figure 12: Sweden: Sectoral financial balances as a percentage share of nominal GDP, 1995 - 2016

… all benefiting from stabilisation elsewhere, i.e. the US …

Figure 13: USA: Sectoral financial balances as a percentage share of nominal GDP, 1995 - 2015

… or the UK …

Figure 14: UK: Sectoral financial balances as a percentage share of nominal GDP, 1995 - 2016,
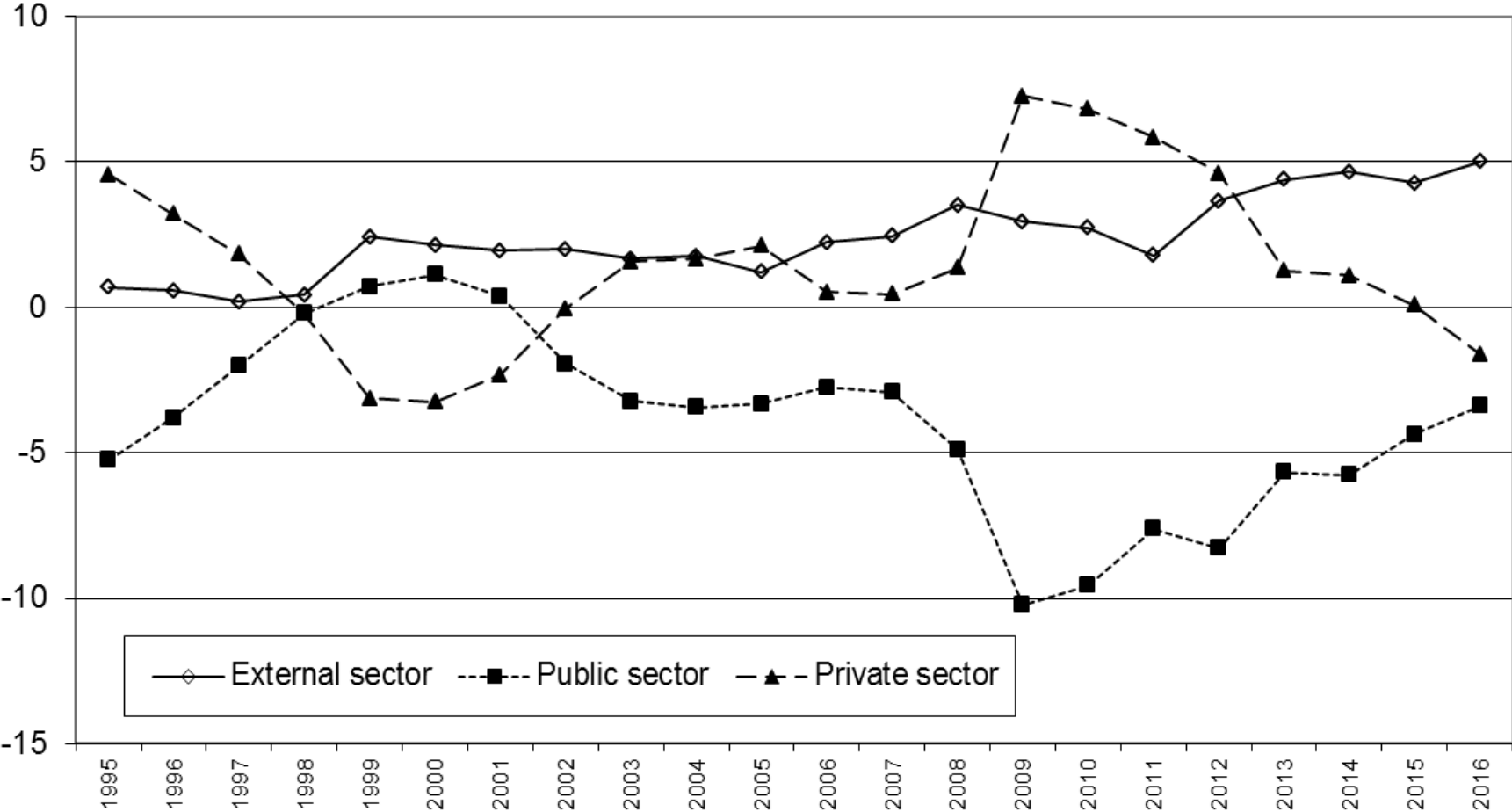
- Steindl (1979, CJE): „Stagnation theory and stagnation policy"

- (Steindl 1976, p. xvii): '[...] thus we witness stagnation not as an incomprehensible fate, as in the 1930s, but stagnation as policy'

- Kalecki (1953, 1971, p. 139): *Political Aspects of Full Employment*

'The reasons for the opposition of the 'industrial leaders' to full employment achieved by Government spending may be subdivided into three categories: (i) the dislike of Government interference in the problem of employment as such; (ii) the dislike of the direction of Government spending (public investment and subsidising consumption); (iii) dislike of the social and political changes resulting from the *maintenance* of full employment.'

A Steindlian model of growth and stagnation

based on Steindl (1952, Chapter XIII), reformulations by Dutt (1995, 2005), Flaschel/Skott (2006)

here: simplification by Hein (2016)

Assumptions:

- Closed private one-good economy
- Fixed coefficients production technology
- No overhead labour, no depreciation
- Harrod-neutral technological change
- Three classes: rentiers, managers/capitalists, workers
- No labour supply constraint
- Mark-up pricing in oligopolistic markets

Pricing and distribution

(1) $\quad p = [1 + m(\rho, \gamma)] wa, \quad m > 0, \dfrac{\partial m}{\partial \rho} \geq 0, \dfrac{\partial m}{\partial \gamma} \geq 0$,

(2) $\quad h = \dfrac{\Pi}{pY} = 1 - \dfrac{1}{1 + m(\rho, \gamma)}, \quad \dfrac{\partial h}{\partial \rho} \geq 0, \dfrac{\partial h}{\partial \gamma} \geq 0$,

(3) $\quad r = \dfrac{\Pi}{pK} = \dfrac{\Pi}{pY} \dfrac{Y}{Y^p} \dfrac{Y^p}{K} = hu \dfrac{1}{v}$.

P: price, m: mark-up, ρ : rentiers' rate of return, γ : outside finance-capital ratio, w: nominal wage rate, a: labour-output ratio, h: profit share, Π : profits, Y: real output, r: profit rate, K: real capital stock, Y^p: potential output, u: rate of capacity utilisation, v: capital-potential output ratio

Financing of the capital stock and rentiers income

(4) $\quad pK = B + E_R + E_F$,

(5) $\quad \gamma = \dfrac{B + E_R}{pK}$,

(6) $\quad \phi = \dfrac{E_F}{pK}$,

(7) $\quad \Pi = \Pi_F + R$,

(8) $\quad R = \rho\left(E_R + B\right)$.

B: debt, E_R: equity held by rentiers, E_F: accumulated retained earnings, γ : outside finance-capital ratio, ϕ : inside finance-captital ratio, Π_F : retained earnings, R: rentiers' income, ρ : rentiers' rate of return

Saving, investment and equilibrium

(9) $\qquad \sigma = \dfrac{S}{pK} = \dfrac{\Pi - R + s_R R}{pK} = h\dfrac{u}{v} - (1 - s_R)\rho\gamma, \quad 0 < s_R \leq 1 .$

(10) $\qquad g = \dfrac{pI}{pK} = \alpha + \omega\hat{y} + \beta(u - u_0) + \theta\left(h\dfrac{u}{v} - \rho\gamma\right), \quad \beta, \theta, \omega > 0, \theta < 1 ,$

(11) $\qquad g = \sigma ,$

(12) $\qquad \dfrac{\partial\sigma}{\partial u} - \dfrac{\partial g}{\partial u} > 0 \quad \Rightarrow \quad (1 - \theta)\dfrac{h}{v} - \beta > 0.$

σ : saving rate, S: saving, s_R: propensity to save out of rentiers' income, g: accumulation rate, I: investment, α : autonomous investment, animal spirits, $\hat{y}$: productivity growth, u_0: target rate of utilisation.

Goods market equilibrium with exogenous technological progress:

(13) $\quad u^* = \dfrac{\alpha + \omega\hat{y} - \beta u_0 + \rho\gamma(1 - s_R - \theta)}{(1-\theta)\dfrac{h}{v} - \beta}$,

(14) $\quad g^* = \dfrac{\left(\alpha + \omega\hat{y} - \beta u_0\right)\dfrac{h}{v} + \rho\gamma\left[\beta(1 - s_R) - \theta s_R \dfrac{h}{v}\right]}{(1-\theta)\dfrac{h}{v} - \beta}$,

(15) $\quad r^* = \dfrac{\left[\alpha + \omega\hat{y} - \beta u_0 + \rho\gamma(1 - s_R - \theta)\right]\dfrac{h}{v}}{(1-\theta)\dfrac{h}{v} - \beta}$.

Responses of goods market equilibrium rates of capacity utilisation (u), capital accumulation (g), profit (r) towards changes in exogenous variables and parameters			
	u*	g*	r*
α	+	+	+
$\omega\hat{y}$	+	+	+
u_0	–	–	–
s_R	–	–	–
h	–	–	–
ρ	?	?	?
γ	?	?	?

Endogenous technological progress and total equilibrium

- Kaldor's (1957, 1961): technical progress function
- Kaldor's (1966): Verdoorn's Law
- Marx (1867), Hicks (1932): wage push

(16) $\quad \hat{y} = \eta + \varepsilon g - \psi h, \qquad \eta, \varepsilon, \psi > 0$.

(17) $\quad g^{**} = \dfrac{\alpha - \beta u_0 + \omega(\eta - \psi h) + \rho\gamma\left[\beta(1 - s_R) - \theta s_R \dfrac{h}{v}\right]}{(1-\theta)\dfrac{h}{v} - \beta - \omega\varepsilon}$.

(18) $\quad \hat{y}^{**} = \dfrac{(\eta - \psi h)\left[(1-\theta)\dfrac{h}{v} - \beta\right] + \varepsilon\left\{\alpha - \beta u_0 + \rho\gamma\left[\beta(1 - s_R) - \theta s_R \dfrac{h}{v}\right]\right\}}{(1-\theta)\dfrac{h}{v} - \beta - \omega\varepsilon}$.

Table 1: Responses of the long-run equilibrium rates of capital accumulation and productivity growth towards changes in exogenous variables and parameters		
	g^{**}	$\hat{y}^{**}$
α	+	+
u_0	−	−
s_R	−	−
h	−	−
ρ	− (normal, debt-burdened) + (puzzling, debt-led)	− (normal, debt-burdened) + (puzzling, debt-led)
γ	− (normal, debt-burdened) + (puzzling, debt-led)	− (normal, debt-burdened) + (puzzling, debt-led)
η	+	+

Figure 1: Stagnation with endogenous productivity growth
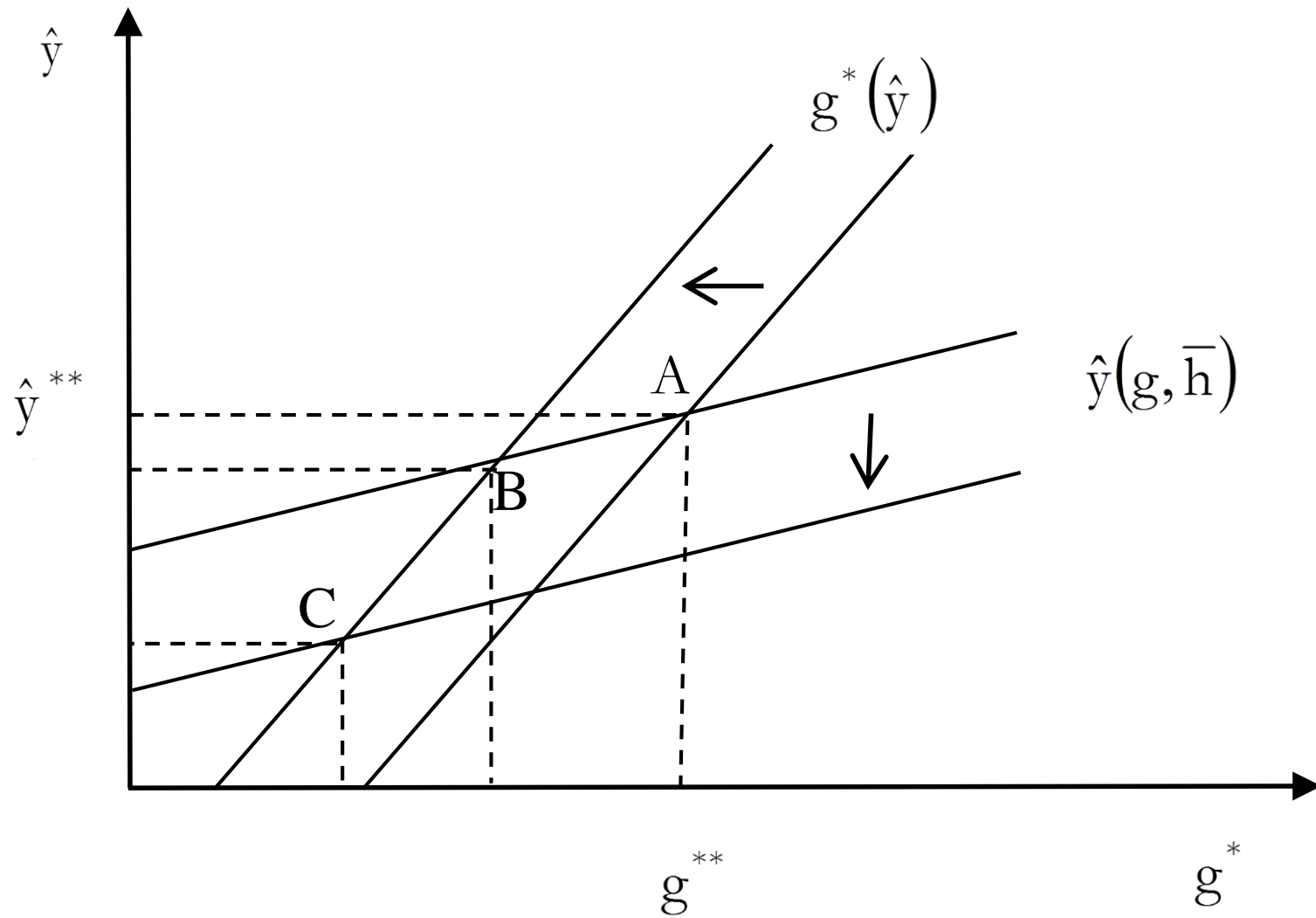
Stagnation policy or stagnation as a political trend

- decrease in autonomous government expenditure growth, reform policies causing falling animal spirits ➔ fall in α

- lower public investment in R&D ➔ fall in η

- weakening workers' and trade union bargaining power, higher interest rates and hence overhead costs ➔ rise in h

- rising inequality in the distribution of household incomes, higher uncertainty triggering precautionary saving ➔ rise in s

- a rise in the rentiers' rate of return, hence the interest rate and/or the dividend rate, and/or the outside finance-capital ratio, hence the debt- and/or the rentiers' equity-capital ratio, if the economy is in the *'normal case'* and in a *'debt-burdened' regime*

Steindlian anti-stagnation policies

- stabilising and raising public autonomous expenditure growth, as well as discretionary anti-cyclical fiscal policies,

- raising growth enhancing public investment, focusing on infrastructure, technology, education and R&D expenditures,

- stabilising and raising the wage share by full employment policies, improving workers' bargaining power, by low interest rate policies, reducing overhead costs, and by the re-regulation of the financial sector reducing the power and income claims of rentiers and shareholders,

- lowering the households' propensity to save by means of redistributing income, both pre-tax via higher wage shares and a more compressed wage structure and after-tax by progressive taxation and social transfers, as well as by removing uncertainty triggering precautionary saving,

- improving international economic and monetary policy coordination in order to avoid severe current account imbalances, 'beggar thy neighbour' strategies, on the one hand, and rising indebtedness in foreign currencies, on the other hand.

	NCM	PKM
Macroeconomic policy recommendations: New Consensus Macroeconomics (NCM) and post-Keynesian(/neo-Kaleckian/Steindlian) macroeconomics (PKM) compared		
Monetary policy	Inflation targeting by means of interest rate policies, which affects unemployment in the short run, but only inflation in the long run	Target low interest rates affecting distribution, and stabilise monetary, financial and real sectors applying other instruments (LLR, credit controls, ABRR)
Fiscal policy	Support monetary policy in achieving price stability, balances the budget over the cycle	Real stabilisation in the short and in the long run, no autonomous deficit target, distribution of disposable income
Labour market and wage/incomes policy	Determines the NAIRU in the long run and the speed of adjustment in the short run, focus should be on flexible nominal and real wages	Affects price level/inflation and distribution, focus should be on rigid nominal wages, steady nominal unit labour cost growth and compressed wage structure
International economic policies	Free trade, free capital flows, flexible exchange rates	Regulated capital flows, managed exchange rates, infant industry protection, regional and industrial policies
Co-ordination	Clear assignment in the long run, co-ordination at best only in the short run	No clear assignment, economic policy co-ordination required in the short and the long run, both nationally and internationally

Limitations of NCM policies in Eurozone

1. In normal times no mechanism to prevent internal current account imbalances:
    single nominal interest rate ➔ divergent real rates; structural reforms in low growth countries made things worse in these countries

2. Great Recession: limits to macro management by interest rate policies (zero lower bound, rising risk + liquidity premia, investment trap); QE has been like ‚pushing on a string'

3. Lack of a ‚lender of last resort' and guarantee of last resort for government debt ➔ euro crisis, gradual movement of ECB (OMT) towards LLR has been linked with austerity measures as prerequesite

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1. **Introduction**

2. **Features of economic stagnation made in the Eurozone**

3. **A Steindlian model of growth and 'stagnation policy'**

4. **'Stagnation policy' made in the Eurozone: main failures of Eurozone macro policies**

5. **A post-Keynesian economic policy proposal for the Eurozone in line with Steindlian anti-stagnation policy**

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Presuppositions

- United States of Europe and proper fiscal federalism are not an option for the near future.

- Alternative policies have to start from existing institutions gradually developing them towards a workable CU

More concrete policy proposals for the Euro area

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

➢ Macroeconomic Dialogue, European Semester, financing institutions for regional and industrial policies (EIB, EIF)

Monetary policy

- refrain from fine-tuning inflation or other macro-variables
- target low real long-term interest rates (i < g)
- contribute to financial stability: credit standards, reserve requirements, credit controls
- most important: lender of last resort for the banking system but also for Euro area 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:

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

(De Grauwe 2011: Euro area wide cap – 2 per cent above German rate)

Wage and incomes policy

- Contribute to stabilising income shares and inflation at Euro area target rate

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

- Contribute to rebalancing (Stockhammer/Onaran 2012):

(19) $\hat{w}_j = \hat{y}_j + p^T + \alpha \left(ULC_{EA} - ULC_j \right),$

- 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
- Euro-area wide minimum wage legislation: ETUC (2012)
- increase minimum wage by inflation target plus national productivity growth each year

Rebalancing via wage policies?

Price competitiveness seems to be of little relevance for CA imbalances within the Euro area:

- Arghyrou/Chortareas (2008, p. 752) for Euro are member states (1975-2005): "relative incomes have been playing a more prominent role than real exchange rates in long-run current account determination."
- European Commission (2010, p. 10): "[a] large part of the cross-country divergence in the current account since the late 1990s is rooted in domestic demand factors."
- and several others …

Schröder (2011), Storm/Naastepad (2014), Kollmann et al. (2014): only small effects of price competitiveness on German trade, which is almost completely explained by foreign demand vs. domestic demand.

➢ Major burden for internally rebalancing the Euro area falls on demand management and industrial restructuring!!
➢ Fiscal policy + industrial + regional policies

Fiscal policy

Focus on real stabilisation, full employment and also a more equal distribution of disposable income, taking into account a balanced current account target:

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

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:

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

(22) $\quad \dfrac{B}{Y^n} = \dfrac{\dfrac{D}{Y^n}}{\hat{Y}^n} \qquad$ or $\qquad \dfrac{B}{Y^n} = \dfrac{\dfrac{D'}{Y^n}}{\hat{Y}^n - i}$

Low interest rates ($i \leq g$) are important for distributional reasons.

Permanent government deficits for public investment in a wider sense + short-run stabilisation in case of cyclical shocks:

(23) $\quad D = D_L + D_S \left(Y^T - Y \right), \qquad D_S > 0$.

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 and the unwillingness to correct deviations should be finally sanctioned (ultimately, the ECB could withdraw its guarantee)

- 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

- Domestic demand in CA surplus countries will be raised, allowing CA deficit countries to reduce CA deficits without constraining domestic demand

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European industrial and regional policy

- Required for catching up and long-run rebalancing
  ➔ improvement of non-price competitiveness

- Short-run effects: growth differentials and hence tendencies towards current account imbalances

- CA deficits and surpluses related to catching up should be tolerated by coordinated fiscal policies

- Criterion for acceptable CA deficits: growth of deficit country is sustainable, exceeds average growth of surplus countries, and also the long-term interest rate

- ➢ no ‚one size fits all' as in Dullien/Schwarzer (2009) (+/- 3 per cent) or Horn et al. (2010) (+/- 2 per cent)

General prerequisites for a sustainable catching up process:

- 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

■ Thank you

Further readings

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