



Munich Personal RePEc Archive

## **Austerity and competitiveness in the Eurozone: a misleading linkage**

Paternesi Meloni, Walter

Department of Economics, Roma Tre University

1 December 2016

Online at <https://mpra.ub.uni-muenchen.de/75962/>

MPRA Paper No. 75962, posted 04 Jan 2017 17:08 UTC

# Austerity and competitiveness in the Eurozone: a misleading linkage

## Abstract

---

After a preliminary focus on increasing government debts, the debate on the “Eurozone crisis” switched over persistent external imbalances - both trade and net foreign assets - among European Monetary Union country members. Endorsing a pure neoclassical view, current account differentials were almost exclusively ascribed to weak price competitiveness of deficit countries (the so called Euro Area periphery), neglecting both demand-side factors and the structural productive asymmetries of the EMU. As a consequence, policy makers decided to impose austerity measures to peripheral countries in order to foster their competitiveness, and consequently to correct external imbalances by means of increasing export - while current accounts realignment mainly occurred due to decreasing import. In this paper, we identify this view as *competitive austerity*, in parallel with the debated *expansionary austerity*.

According to their proponents, these policies would have a direct impact on trade balances and expansionary effects on real output and employment. By contrast, from an alternative standpoint fiscal restraints can be generally considered as counterproductive. In this perspective, following Keynesian arguments the aim of this paper is to critically assess the austerity-competitiveness linkage from a theoretical perspective. Moreover, some macroeconomic evidences are suggested to evaluate both effectiveness on external positions and real side-effects of austerity policies.

---

**Keywords**                      austerity, competitiveness, European imbalances, current account,  
fiscal policy, aggregate demand

**JEL classification**        E63, F32, F45



*Please consider the environment before printing this paper*

-----  
I am grateful to Antonella Stirati, Enrico Sergio Levrero, Fabrizio Antenucci, Matteo Deleidi and Gian-Luca Merlini for useful suggestions on earlier drafts of this paper. I also thank for worthwhile comments all participants at *A/simmetrie conference* (Pescara, 27/28 April 2015) and *World Congress of Comparative Economic* (Rome, 25–27 June 2015), where preliminary versions of this paper were presented. All remaining errors or omissions are, of course, my own.

\* Department of Economics, Roma Tre University - walter.paternesi@uniroma3.it

## 1. Introduction

Recently, the debate on Eurozone crisis, i.e. the widening of government bond spreads, have switched from “fiscal indiscipline” (increasing public debts, or debt-to-GDP ratios) to external macroeconomic differentials among EMU country members, especially due to the fact that intra-Euro trade imbalances have increased after Euro inception. Endorsing a pure *neoclassical* view, current account (henceforth, CA) imbalances have been almost referred to a lack of price competitiveness of deficit countries (*supply-side* factors), while little attention has been paid to real growth differentials (*demand-side* factors) and to the structural productive asymmetries of the Eurozone (henceforth, EZ).

According to these *mainstream* arguments, policy makers decided to tackle EZ crisis by imposing fiscal austerity measures to deficit countries, and these policies were firstly declared to contain debt-to-GDP ratios: conventional economic literature called this view *expansionary austerity*, inasmuch fiscal consolidation was also considered able to increase total income. In this paper, we argue that once austerity measures did not have achieved expected results, restrictive fiscal policies have been still imposed albeit in something what different guise from their usual one: still following *mainstream* arguments, austerity was considered able to affect trade balances by promoting exports. On these basis, increasing competitiveness would be achievable through wage deflation joined with “structural reforms” - i.e. labour market deregulation - aimed to foster productivity. In parallel with *expansionary austerity*, we identify this view as *competitive austerity*, that is a causal connection (supposed by policy makers) between fiscal restraints and external competitiveness.

Following Keynesian arguments, the aim of this paper is to critically assess the austerity-competitiveness linkage. From a theoretical standpoint, we analyse the *mainstream* approach underlying restrictive fiscal policies which aim to promote external competitiveness, we highlight its weaknesses and we suggest an alternative economic perspective. Besides, by means of macroeconomic evidences we discuss both effectiveness and side-effects of restrictive policies on real economy (total output, domestic demand, unemployment and income distribution). Especially, we show that CA deficits often decreased as austerity confined the endogenous component of import by containing aggregate demand, and consequently real income.

The paper is organised as follows. In Section 2, we present the state of the art: after an overview on the new EMU economic framework, we report arguments provided by literature about the EZ crisis genesis, as well as we discuss policies adopted to face the crisis - at the beginning *expansionary austerity*, while at a later time *competitive austerity*. In Section 3 we focus on the theoretical framework underlying this dual interpretation of austerity, even if we will pursue our analysis setting aside *expansionary austerity* (even the original proponents have now called into question its validity) and focusing on *competitive austerity* - the specific topic of this essay. Afterwards, on the basis of a wide economic literature which suggested that CA imbalances may matter even within a monetary union, in Section 4 we advance a twofold explanation about the roots of CA misalignments: especially, price competitiveness and growth differentials played a key role in trade imbalances. In Section 5 we consider how austerity policies would have affected current account misalignments through a case-by-case study on GIIPS countries (namely,

Greece, Italy, Ireland, Portugal and Spain). Then, following Keynesian arguments Section 6 focuses on restrictive fiscal policies effects on real output, employment and public debt-to-GDP ratios: we provide both theoretical arguments and macroeconomic evidences in order to refute the austerity-competitiveness link. In Section 7 we finally disprove this linkage, and we conclude by suggesting an alternative recipe to fiscal austerity policies for the Eurozone.

## 2. Austerity and Competitiveness within EMU: state of the art

### 2.1 - EMU: a new economic framework

After a long and quite strenuous journey, in 1999 several European countries decided to join the European Monetary Union (henceforth, EMU). As one key tool of adjustment was removed by waiving exchange rate flexibility, from the beginning EMU countries ability to face negative macroeconomic and financial shocks was considered the main challenge for the success of the single currency<sup>1</sup>. Moreover, as EMU treaties were not joined to banking and fiscal union, financial regulation and fiscal policies were kept under each national government responsibility: however, both *Maastricht Treaty* (1992) and *Stability and Growth Pact* (1997) committed member state to rigorous convergence criteria, as well as to strict public finance constraints after the onset of the Euro. In a nutshell, monetary union has led to a greater market openness, combined with a stricter room for manoeuvre in using macroeconomic variables (e.g. confined government expenditure, no exchange rate adjustments, *one-size-fits-all* monetary policy).

On the basis of the above, the outbreak of global financial crisis (2007/08) represented the first test for EMU stability: ECB opted for loose monetary policies in order to dampen financial shocks<sup>2</sup>, even if the financial crisis brought about a reassessment of asset prices, especially for countries showing macroeconomic imbalances - in 2009 some countries experienced a greater deficit-to-GDP ratio<sup>3</sup> than allowed by treaties, although this depended on tax revenue reductions greater than national income losses<sup>4</sup>. However, there was little concern about sovereign debts until speculative attacks on countries experiencing macroeconomic imbalances fostered increasing fear about a debt crisis among investors. This in turn led to troubles in refinancing public debts on markets: Greece, Ireland, Italy, Portugal and Spain (GIIPS) experienced a rise in government bonds yields<sup>5</sup> compared to other EU members - so called "credit spread", especially *vis-à-vis* Germany. Downgrading of public debt securities stimulated alarms on financial markets too: despite the monetary union, a single interest rate was no longer available in the

---

<sup>1</sup> An institutional research [European Communities, 1990] stated: "The main potential cost of EMU is that represented by the loss of monetary and exchange rate policy as an instrument of economic adjustment at the national level". This loss was not considered to be "exaggerated" since "relative real labour costs will still be able to change", and "budgetary policies at national and Community levels will also absorb shocks". However, the same paper asserted that "fiscal policy should not be used to delay market adjustments (e.g. real wage adjustments) when those adjustments are required", and "wage discipline will also be more effective in a credible EMU". Briefly, in case of macroeconomic imbalances (especially, trade deficits) EMU original project clearly provided for the burden of the adjustment was passed on wages, with a negligible role for fiscal policy.

<sup>2</sup> After *Lehman Brothers* default, during 2008/2009, ECB lowered interest rates seven consecutive times.

<sup>3</sup> General government structural deficit (% of potential 2009 GDP): Greece 19.11; Ireland 9.89; Italy 4.13; Portugal 9.17; Spain 9.28 (Source: IMF, *World Economic Outlook*).

<sup>4</sup> Economic recessions can generate increasing public deficits owing to automatic stabilizers. Moreover, some countries faced banking sector crisis by government rescue operations (this was not the case of Italy and Portugal).

<sup>5</sup> GIIPS yield differentials relative to Germany peaked (base points) at different times: Ireland on July\_11 (1323); Italy on November\_11 (542); Spain on November\_11 (543); Portugal on January\_12 (1576); Greece on February\_12 (3399).

Eurozone. However, in this regard we must emphasize the institutional framework of the EMU: in fact, ECB Treaty did not require direct purchase of sovereign bonds<sup>6</sup> in order to dampen yields.

In parallel, policy makers decided to face EZ crisis by using a specific recipe: fiscal austerity was considered the proper tool to reduce differentials between GIIPS and Germany government bond yields. According to this view, austerity was considered to be expansive, i.e. to reduce debt-to-GDP ratios also by fostering real growth through restoring investors confidence (*expansionary austerity*), hence it would lower the risk of peripheral countries leaving monetary union. By contrast, from a Keynesian perspective it can be argued that austerity measures may actually foster market uncertainty, since debt-to-GDP ratio could boost given the size of fiscal multipliers [Ciccone, 2002; Nuti, 2013; Leão, 2013].

## 2.2 - A change in perspective: from fiscal policy to external imbalances

Nevertheless, the *mainstream* argument that EZ sovereign debt crisis was mainly driven to fiscal indiscipline [Attinasi & al., 2009; Sinn, 2012; Wyplosz, 2013] - and then GIIPS countries should fulfil fiscal consolidation - appeared questionable because several EMU countries showed a “healthy” fiscal position before the beginning of the global financial crisis<sup>7</sup>: by 2007, Italy, Austria, Belgium, Finland, Ireland, Netherlands and Spain reduced their debt-to-GDP ratio compared to 1999. Besides, a comparison among EZ countries with other no-EMU economies<sup>8</sup> is useful to understand that fiscal policy itself is not sufficient to explain sovereign debt risk (e.g. debt-to GDP ratio, from 1999 to 2007, Japan +51%; USA and China +6). However, public debt levels were quite high for Italy and Greece, Portugal trend was increasing too, while Ireland and Spain fiscal ratios appeared relatively solid. Furthermore, low credit spreads indicated that markets did not consider a substantial “default risk” before 2007.

At a later time, in order to tackle global financial crisis some governments have forced to implement banking rescue packages: as a result, both deficit and debt ratios grew significantly - to this regard, empirical evidence shows that Italy was one of the less serious case<sup>9</sup>. As a matter of fact, although in 2012 peripheral countries - except Spain - showed a higher debt-to-GDP ratio than the North (Italy, Ireland, Portugal and Greece over 100%), almost all member states exceeded the 60% *Maastricht Treaty* criterion.

In the meanwhile, EZ crisis was paying the attention on persistent external imbalances among EMU country members, both in trade and in net foreign assets<sup>10</sup>. Nevertheless, the sudden rise of spreads led policy makers to focus on public debt sustainability, leaving aside external imbalances issue. However,

---

<sup>6</sup> As we are going to show, only after EZ crisis - and only in order to dampen yield differentials - purchases on government bonds secondary market (at market prices) have been allowed.

<sup>7</sup> De Grauwe [2011] shows pre-crisis dynamics of public and external debts in peripheral countries (as share of GDP): Ireland, Italy and Spain reduced their public exposures, Greece kept it stable, while only Portugal experienced a raise. In the meanwhile, all these countries increased their foreign debts, rooted in private sector - not in the public field. Then, data seem to show that spreads widening was not fuelled by high debt-to-GDP ratios.

<sup>8</sup> To be fair, there is a clear difference between EMU member states and no-EU countries. In several countries proper tools to sustain real economy and to avoid fiscal crisis are available, e.g. central banks may directly buy sovereign bonds in case markets will not. This allows to achieve large deficits through expansionary fiscal policies in order to support real economy during recessions, avoiding market losses of trust or public debt “unsustainability fears”.

<sup>9</sup> General government gross debt (as % of GDP) changes over the period 2007/12: Austria +14%, Belgium +15%, Germany +17%, Finland +18%, Italy +23%, France and Netherlands +26%, Spain +48%, Greece +51%, Portugal +55%, Ireland +92% (Source: IMF, *World Economic Outlook*).

<sup>10</sup> For an overview of external debt trends, see Lane & Milesi-Ferretti [2007, *updated and extended dataset*].

economic literature (both *mainstream* and *non-conventional*) suggested that persistent CA imbalances between deficit and surplus countries among EMU appeared able to cause a sovereign debt crisis [Brancaccio, 2008; Cesaratto, 2010, 2012; Giavazzi & Spaventa, 2010; Wolf, 2012; Alessandrini & al., 2012; Hallet & Martinez Oliva, 2013]. Put it simply, deficit countries might consider the opportunity to quit the monetary union to recover exchange rate adjustments, and consequently external debt would experience a devaluation. This alternative view on the EZ crisis represented a significant turning point for the economic debate since it highlighted the controversial issue of “competitiveness”. As a matter of fact, intra-Eurozone CA imbalances were negligible before EMU, while after 2003 Portugal, Greece and Spain were running large external deficits, and Germany experienced large external surpluses - even if the overall Euro area current account balance was close to zero.

### 2.3 - EMU and current accounts imbalances

Although the first interpretation of intra-Eurozone CA imbalances maintained they were not problematic<sup>11</sup> [Blanchard & Giavazzi, 2002], at a later time economic literature considered external deficits as able to create alarming macroeconomic scenarios - i.e. a sovereign debt crisis in case they would foster credit spreads, even in absence of fiscal irresponsibility - by the following three channels.

First of all, Blanchard [2007] argued that external imbalances - even within a monetary union - are problematic in case capital inflows fuelled investment on *non-tradable* sectors (e.g. housing) and crowded out *tradable* sector - by drawing resources away from more productive industries. According to this strand of literature, such phenomenon could be problematic within a monetary union since external adjustment would take place only through internal devaluation: in this framework, all labour market rigidities will lead to a persistent increase in unemployment since they will not allow real wages to fall.

Secondly, Merler & Pisani-Ferry [2012] argued that CA deficits can lead to liquidity crisis: owing to the financial integration (i.e. no exchange risk and lower interest rates), EZ peripheral countries experienced strong credit booms, and a liquidity shortage would be feasible in case of a “sudden stop” in funding credit markets<sup>12</sup> - if capital flows are brokered, such reversal might cause a banking crisis.

Thirdly, other authors suggest that an external deficit might affect interest rates structure as it could be seen as a signal of “weak” country competitiveness. In detail, increasing external debts could suggest deficit countries to leave the monetary union in order to recover exchange rate tool - e.g. employers’ federations could require a competitive devaluation in order to foster export; then, foreign creditors would reply to this pressure by claiming a risk premium asking for higher interest rates to protect their positions from capital losses from currency devaluation [Brancaccio, 2011], and as a consequence yield differentials within the monetary union would be experienced since markets might bet on public debts whose countries could quit the currency union. Furthermore, we argue if a persistent external imbalance is likely to bring about actual industrial decline, a kind of social fear related to a de-industrialization process could rise in deficit countries, and this would have a backlash on markets confidence.

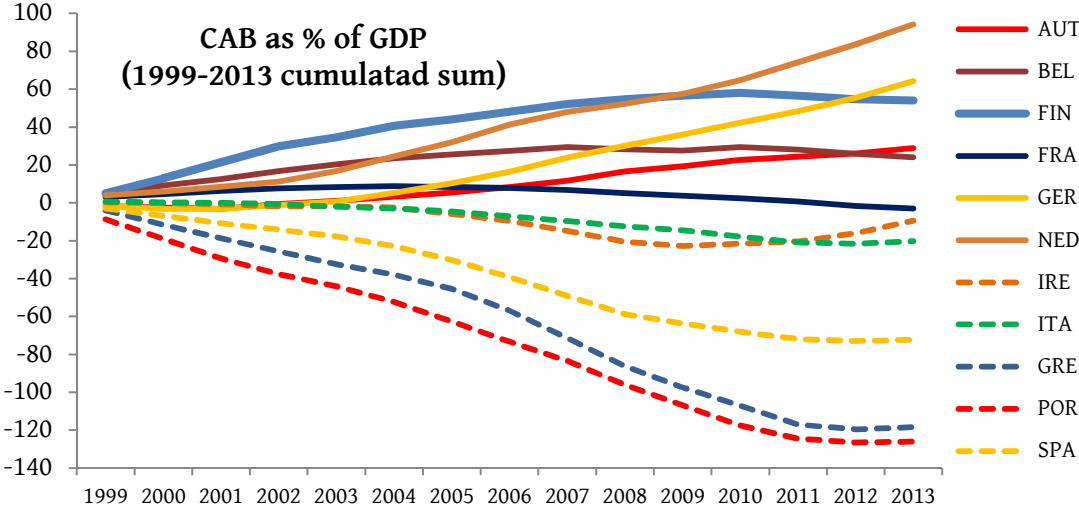
---

<sup>11</sup> According to the “convergence theory”, imbalances will automatically reabsorb (where capital is scarce) since capital flows would stimulate productivity. However, this was not the case of EZ, since convergence has not occurred. In order to overcome this inconsistency, *mainstream* economists usually argue that in deficit countries capital flows fuelled *unproductive* investments (e.g. housing).

<sup>12</sup> However, liquidity risks within EZ have been mitigate by policy makers through TARGET-2 system.

In addition to literature explanations, an alternative reading of EZ crisis could be advanced: yield spreads have been merely caused by speculative attacks on countries showing macroeconomic imbalances since investors were fully aware about institutional EZ framework, i.e. ECB would not intervene by supporting government bonds demand in case of troubles in debt refinancing<sup>13</sup>. If it was true, EZ sovereign debt crisis would be totally independent of external imbalances, while it would be only related to the institutional framework of the monetary union. However, economic literature advanced reasons that intra-EZ imbalances could pose the problem of EMU stability, both because of lack of a fiscal union (able to absorb transitory shocks<sup>14</sup>), and owing to speculative attacks<sup>15</sup> against individual member countries.

Graph 1 - Source: OECD, Main Economic Indicators (author's elaboration)



As a matter of fact, single currency inception has boosted trade imbalances. Differentials among European countries CAs increased, leading to the creation of two structurally different areas (see Graph 1): member countries with large CA surpluses - the so-called *core countries* (Germany, Austria, Belgium, Netherlands and Finland) - and symmetrically member countries that have seen worsening their CA deficits - the so-called *peripheral countries* (Spain, Portugal, Ireland, Greece and Italy). Nevertheless, it is useful to highlight that EMU represented a sort of turnabout for some countries: Germany had been experiencing a CA deficit with EZ before 1999, while actually it is achieving huge surpluses.

Furthermore, the EZ crisis can be related to CA misalignments referring to the high volume of bank loans disbursed from surplus to deficit countries before the outbreak of the crisis, to the subsequent deadlock of these flows and, therefore, to increasing imbalances in the TARGET-2 system. In a nutshell, although a strict focus on fiscal policy could suggest that “fiscal indiscipline” was the main determinants of

<sup>13</sup> Cesaratto [2015], Zezza [2012] and Benigno [2012] seem to consider this alternative reading of EZ gov’ bonds crisis.  
<sup>14</sup> Within a fiscal union, in case an area shows a trade surplus its income will increase, leading to a greater fiscal revenue. In the meanwhile, a deficit area will experience low growth and increasing unemployment: here, welfare expenditure - available exploiting the greater fiscal revenue of surplus areas - can balance trade deficit negative effects. Obviously, a fiscal system makes imbalances sustainable, but it does not eliminate them: a development policy of deficit areas is required in order to absorb imbalances. Within EZ framework, TARGET-2 system has been implemented: however, we argue it can solve only liquidity troubles, without redistributive effects among surplus and deficit areas.  
<sup>15</sup> Owing to the monetary union, speculation could be shifted from exchange rates to government bonds: while interest rates on GIPS sovereign debt were climbing, German yields declined, as well as US, UK and Japan ones [Alessandrini & al., 2012]. This could be a signal of a speculative attack, intended as capital reallocation among different assets.

governments bond spreads, it can be argued that the role of public debt was negligible, while external imbalances emerge as key factors to explain interest rate differentials.

#### 2.4 - The austerity recipe again

According to policy makers, austerity was the proper cure to EZ crisis since spreads are lowered due to the fact that undisciplined countries finally made fiscal adjustment. Contrariwise, we claim that credit spreads decreased due to ECB intervention, whose refinancing operations<sup>16</sup> (conditionally to fiscal austerity plans<sup>17</sup>) were aimed to sustain governments' bonds demand on the secondary market. Although restrictive fiscal measures worsened debt-to-GDP ratios and depressed total output - in contrast with the *expansionary austerity* view - restrictive policies has been pursued, even if their focus has been switched over real imbalances. Briefly, austerity was even based on the assumption that GIIPS countries have been both fiscally irresponsible and not able to implement *supply-side* policies<sup>18</sup> in order to increase their competitiveness. So, peripheral countries were forced to implement austerity measures for two reasons: firstly, to re-establish government debt sustainability, i.e. to reduce debt-to-GDP ratio by mitigating market losses of trust and by lowering risk premiums (*expansionary austerity*); secondly, to restore external competitiveness through internal devaluation, real wage reduction and structural reforms (*competitive austerity*). However, from a theoretical standpoint such adjustment was suddenly considered counterproductive and self-defeating by *non-conventional* economists<sup>19</sup> as austerity can foster depression and unemployment. In this framework, we argue that the whole EMU sustainability would become crucial, challenged by rejections against excessive fiscal disciplines and nationalist tendencies<sup>20</sup>.

Nevertheless, according to *Troika* restrictive measures would *restore investors confidence*<sup>21</sup> by improving debt-to-GDP ratios<sup>22</sup> even by rising income - also getting better trade performances. Although *Maastricht Treaty* provided a strict fiscal discipline (3% deficit-to-GDP and 60% debt-to-GDP criteria), austerity measures were implemented in 2009 in order to face the sudden rise of credit spreads as a counterpart to

---

<sup>16</sup> Especially, we refer to LTROs (2011 and 2012), as well as to OMT, EFSF and ESM: these operations were considered as bypassing of the "no bailout clause" provided for Maastricht Treaty. However, they were consistent with ECB purpose to preserve Euro area financial stability, since "Within our mandate, the ECB is ready to do whatever it takes to preserve the Euro. And believe me, it will be enough (...) To the extent that the size of the sovereign premia hamper the functioning of the monetary policy transmission channels, they come within our mandate" (Mario Draghi, 26.07.12).

<sup>17</sup> This mechanism is usually identified as *structural adjustment*, a combination of free market policies (e.g. privatisation, fiscal austerity, free trade, deregulation). By definition, the EFSF's mandate is "to safeguard financial stability in Europe by providing financial assistance to Euro area Member States within the framework of a macro-economic adjustment programme".

<sup>18</sup> Alesina & Perotti [2010] stated: *a monomaniacal focus on aggregate demand is based on slightly outdated and oversimplified Keynesianism; the real constraint on European growth is not Germany's fiscal policy: it is the supply side rigidities that plague all European nations - especially those at the heart of this crisis. Authors argue that Germany competitiveness come from limited and timid labour market reforms.*

<sup>19</sup> We mainly refer to "Lettera degli Economisti" to policy makers (14.06.2010) which headlined: "Restrictive policies deepen crisis, feed speculation and can lead to the deflagration of Euro area. An alternative economic policy is required to prevent a further fall in income and employment" (our translation - full text available on <http://www.letteradeglieconomisti.it/>).

<sup>20</sup> A feasible negative scenario had already been predicted by Kaldor [1971]: "Some day the nations of Europe may be ready to merge their national identities and create a new European Union (...). This will involve the creation of a full economic and monetary union. But it is a dangerous error to believe that monetary and economic union can precede a political union or that it will act (...) as a leaven for the evolvment of a political union which in the long run it will in any case be unable to do without. For if the creation of a monetary union and Community control over national budgets generates pressures which lead to a breakdown of the whole system it will prevent the development of a political union, not promote it".

<sup>21</sup> We are referring to ECB recommendation letter to Italian government (Frankfurt, August 5, 2011).

<sup>22</sup> A well-known study [Reinhart & Rogoff, 2010] empirically showed that government's debts exceeding 90% of GDP are often correlated with low real growth. This kind of studies has exercised an important influence on fiscal policy debate, providing significant support for the *austerity agenda* that has had increasing success in Europe.

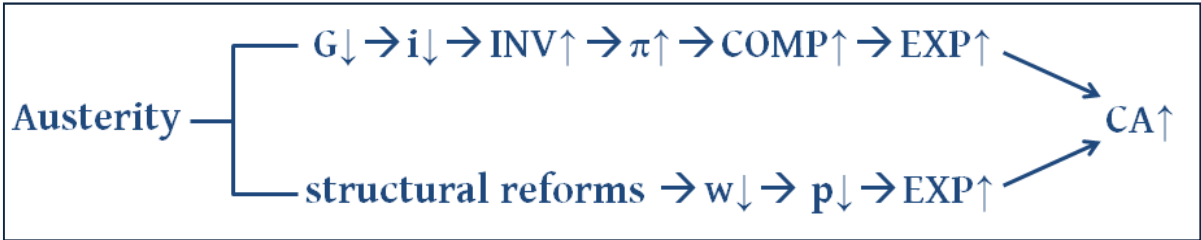


ECB rescues on government debt; then, fiscal restrictions continued with *Euro Plus Pact* (2011), and *European Fiscal Compact* (2012). Apart from public debt sustainability (*expansionary austerity*), from policy makers perspective austerity measures would restore competitiveness (*competitive austerity*) and reduce CA imbalances through two distinct channels<sup>23</sup> (see Box\_1):

1. increasing price competitiveness by fostering investments and productivity ( $\pi$ );
2. stimulating export by reducing nominal wages ( $w$ ) and prices ( $p$ ) through *structural reforms*.

These measures focus on the *supply-side* in order to foster price competitiveness based on unit labor cost (ULC) and real effective exchange rate (REER): increasing exports would consequently reduce CA deficits.

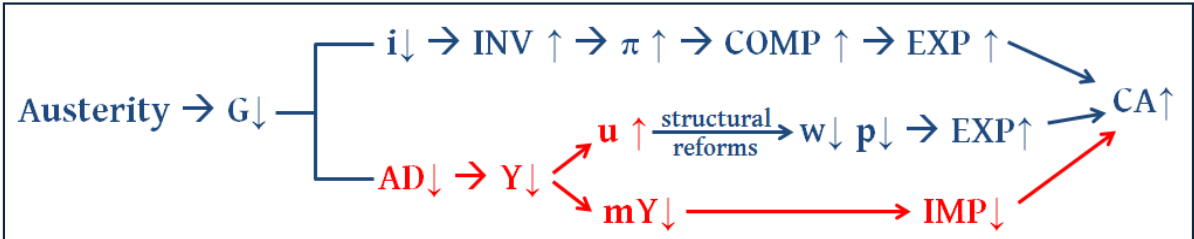
Box\_1 - From austerity to current account: declared transmission channels



With regard to the *productivity channel*, since interest rate is determined on investments/savings market - as assumed by *neoclassical* economic theory - public expenditure would increase the market clearing interest rate, and this in turn would negatively affect investment. Therefore, government spending results in a lower private spending: in other words, public expenditure crowds out investments - even an equal amount in full employment. Contrariwise, a reduction in public spending will have positive effects on output since it would leave more available resources to the private sector (considered, owing to the profit purpose, more efficient than the public sector), as well as a lower interest rate would stimulate private investment<sup>24</sup>, which in turn would increase productivity, foster competitiveness and export.

With regard to the *wage channel*, structural reforms mainly refer to the labor market deregulation: in this view, increasing price competitiveness (i.e. cheaper national goods) would be achievable through lower wages, then internal deflation would be realized through proper reforms which, in addition to eliminate wage indexations, would decentralize the bargaining processes and make job agreements more flexible.

Box\_2 - From austerity to current account: effectual transmission channels



<sup>23</sup> As we will see in the following, these channels appear consistent with our explanations of imbalances drivers.

<sup>24</sup> By contrast, from a *Keynesian* perspective investment decisions are taken based on expected demand and only secondly based on interest rate, hence it is improper to establish a link between the investment-saving market and the interest rate. Furthermore, saving decisions are taken by households on the basis of disposable income, hence there is no assurance that the interest rate will actually be a price balancing investments and savings. Finally, in the actual EZ framework interest rate is linked to ECB policies, thus it can be considered as an exogenous variable: consequently, the argument that increasing government spending would rise interest rate appears highly questionable.

In parallel with these openly declared channels, from a *demand-side* standpoint we argue that austerity measures actually contain income growth<sup>25</sup> by reducing aggregate demand: according to this complementary view, restrictive fiscal policies have led to CA realignments by containing total imports, i.e. by reducing their endogenous component *via* marginal propensity to import. Moreover, by reducing aggregate demand - and, according to the usual Keynesian view, total output - austerity measures will cause increasing unemployment (see Box\_2): this in turn would justify structural reforms, especially the labor market deregulation which, according to the *mainstream* view, is able to reduce unemployment by means of the market clearing wage rate. However, *demand-side* channels are not explicitly stated in policy makers documents<sup>26</sup>, while they actually worked in deficit countries.

### 3. “Expansionary” and “competitive” austerity: a puzzling theoretical framework

Since austerity has not yet produced positive effects on debt-to-GDP ratio (neither expansionary effect on real output) and *Troika* has been continuing to enforce restrictive fiscal plans to GIIPS countries in order to achieve public debt consolidation and to reduce external imbalances<sup>27</sup>, we argue that a proper focus on the theoretical underpinnings of this twofold interpretation of restrictive policies (*expansionary* and *competitive austerity*) appears crucial to investigate on its transmission channels.

#### 3.1 - Expansionary austerity

Fiscal restrictions are based on *mainstream* economic literature which refers to the so called “*expansionary fiscal contraction*”, based on a definite hypothesis: since reductions in government spending will positively affect representative agent’s expectations (due to decreasing future taxes), a fiscal contraction will expand private spending, then it will lead to economic expansion. The concept that fiscal restraint can result in real growth is commonly known as *expansionary austerity*<sup>28</sup>. The theoretical framework underlying this argument is the modern refining of the *Ricardian equivalence proposition*, which states that “deficit spending” has no real effects: according to this argument, forward looking consumers internalise government's budget constraint in making their intertemporal expenditure decision. As a consequence, how to finance a given expenditure pattern (raising taxes or issuing bonds) will not affect agents' consumption decisions, and thus it will not change aggregate demand. Hence, this approach is often used as an argument against tax cuts aimed to foster aggregate demand, since deficits will simply postpone taxes. According to the hypothesis, if government financed spending through deficits, taxpayers would anticipate they would have to pay higher taxes in future. As a result, they would increase their savings to pay increasing future taxes (i.e. they reduce their current consumption). Similarly, effects on aggregate demand would have been the same in case government had chosen to tax now. However, Ricardo itself

---

<sup>25</sup> Theodoropoulou & Watt [2011] quantified the impact of austerity measures on total income. Fiscal adjustment programmes were estimated (2010/2011, % of GDP) in: SPA 0,5/0,9; GRE 5,6/6,3; IRE 2,1/2,6; POR 1,2/4,9.

<sup>26</sup> *Euro Plus Pact* (so-called *Competitiveness Pact*), *European Fiscal Compact* and several ECB recommendation were measures related to the EZ agenda which is consistent with our dual characterization of *expansionary* and *competitive* austerity.

<sup>27</sup> Referring to Greece, *European Commission* [2010] states: “(a) significant policy action is needed... (it) should be conducive to increasing fiscal consolidation while at the same time contributing to the necessary competitiveness adjustment”.

<sup>28</sup> This expression has been coined by Alesina & Ardagna [2009].

was quite unconvinced about the empirical relevance [Ricardo, 1820], since the *Ricardian equivalence* requires challengeable assumptions<sup>29</sup>. Moreover, we argue that the theoretical link between *Ricardian equivalence* and *expansionary austerity* is, at best, not clear: according to the former view, deficit spending has no real effects on the economy, while according to the latter restrictive fiscal policies are even able to increase real output.

However, on the basis of the aforementioned arguments actual economic literature usually refers to budget-cutting, including an additional *neoclassical* assumption: decreasing government expenditure will reduce *crowding-out* effect, making *room for the private sector to expand* [Giavazzi & Pagano, 1990], while fiscal consolidation is able to restore business confidence by lowering interest rates, then creating incentives for further investment (*crowding-in* effect). Hence, fiscal consolidation is considered to be related with economic growth when realized by reducing public expenditure [Alesina, 2010; Alesina & Perotti, 1995]. By contrast, we assert that empirical literature does not provide clear evidence in support of *expansionary austerity* - even *World Economic Outlook* [IMF, 2010] argued that austerity measures are repressive in the short run, while they remain expansionary in the long run. Finally, we can argue that albeit higher taxes and lower spending would lead to decreasing government's deficit, in case austerity caused lower economic growth governments would also face low cyclical tax revenue due to decreasing employment - i.e. income tax revenue may fall.

### 3.2 - Competitive austerity

According to *mainstream* arguments, cuts in public spending will increase private investment, since government expenditure is considered able to crowd out private spending both subtracting market share to private agents and raising interest rates. Consequently, investments will decrease since they are considered to be negatively dependent on interest rate. This view assumes also that private agents are more efficient than public operators, hence an economy with poor public interference is roughly considered to be more efficient, more productive and more competitive.

Furthermore, owing to government wage bill accounts for a sizable share of total public expenditure, austerity leads governments to reduce staff expenditure *via* cuts in wages or downsizing total employees. *De facto*, lowering (or freezing) public sector wages will have a direct impact on the whole frame of wages: in case public employees become redundant, unemployment will increase. As a consequence austerity measures will tend to reduce both consumer and business confidence, so fears over job losses and expectations of lower growth will encourage consumers to save rather than spend: this is inconsistent with *expansionary austerity* arguments.

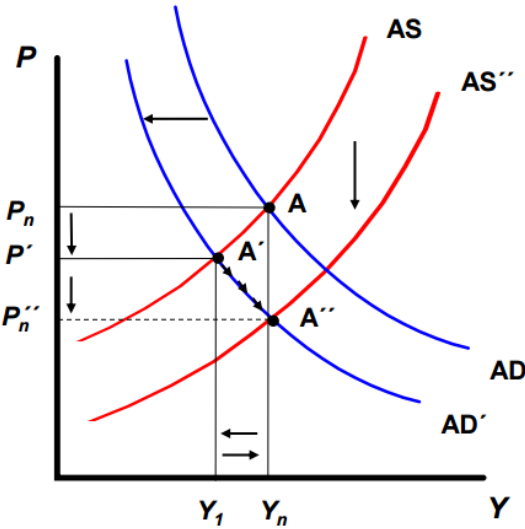
Moreover, deflationary effect might be achieved through "fiscal devaluation", a topical tax reform which refers to a budget-neutral reduction of labor taxes combined with changes in other government revenues. Especially, a reduction of employers' social contributions would be financed by raising value added tax rate [Calmfors, 1998]. According to this view, this fiscal mechanism might stimulate real economy: while nominal wages are not immediately adjusted to decreasing social contributions, labor

---

<sup>29</sup> Firstly, perfect capital market hypothesis is often held up for particular criticism because liquidity constraints invalidate the assumed lifetime income hypothesis. Secondly, international capital markets could also get the whole framework more complex. Thirdly, uncertainty about future income levels will increase agents liquidity preference for precautionary purposes, reducing actual consumption. Finally, actual unemployment can aggravate this scenario, by worsening expectations and by boosting liquidity preference.

costs are reduced, then export would increase. However, increasing VAT rate will depress consumption and imports, while exports will remain unaffected: in so doing, trade balance is expected to improve. Furthermore, increasing transfers (e.g. retirees, social benefits) are widely considered able to produce an increase of non-tradeables relative prices, hence a loss of competitiveness: *mainstream* authors argue this will lead to decreasing employment in domestic economy [Alesina & Perotti, 1994]. Following this reasoning, austerity measures are supposed to create greater pressure to reduce costs, hence to improve price competitiveness<sup>30</sup>. According to their proponents, all these mechanisms would operate if combined with a set of free market policies (privatisations of state owned industries, free trade and deregulation to encourage competition) considered as crucial for promoting efficiency and market openness. To sum up, according to these arguments GDP increases are related also to external performances, then policy makers usually consider external competitiveness as the main driver for economic growth even if within a highly integrated economic area as the EZ - where whole area trade is almost on balance.

Figure 1 - The dynamic effects of a decrease in the budget deficit [Source: Blanchard & Johnson, 2013]



In addition to these explanations, within *mainstream* theories restrictive fiscal policies would automatically affect external trade since austerity measures have an outright impact on prices and wages insofar as they affect aggregate demand: assuming a simple AD-AS model (see Figure 1), a fiscal contraction - for instance, a decrease in government spending, taxes being equal - will shift the aggregate demand curve leftwards (from AD to AD'). The new equilibrium would involve a fall in prices ( $P'$  is lower than  $P_n$ ), while it would imply a decrease in the equilibrium output ( $Y_1$  is below its natural level  $Y_n$ ) and employment. In this regard, we can immediately observe a basic contradiction with *expansionary austerity* measures, which are described as able to expand total income. However, *mainstream* economics consider this real contraction as confined to the short run: in the medium run aggregate supply would move down (from AS to AS'') and a new equilibrium would be reached at  $Y_n$  with lower prices ( $P''$ ). Put it simply, fiscal restrictions are considered able to decrease prices - without depressing

<sup>30</sup> Perotti [2011] analyses four countries debt-consolidation experiences (Denmark; Ireland; Finland; Sweden). He claims: "All four episodes were associated with an expansion; but only in Denmark the driver of growth was internal demand... In all cases interest rate fell fast, and wage moderation played a key role in generating a gain in competitiveness and a decline in interest rates... Wage moderation was facilitated by the direct intervention of the government in the wage negotiation process".

real output - and to foster export by decreasing real exchange rates. This mechanism is considered as symmetric, since expansionary fiscal policies would increase prices (without fostering real output, which would be at the natural level) and to decrease export by increasing real exchange rates.

#### **4. Explaining imbalances: competitiveness, demand booms or something else?**

In addition to theoretical issues, empirical evidence suggests a twofold explanation of CA misalignments: especially, both price competitiveness (driving exports) and growth differentials (affecting imports) played a key role in their genesis. Moreover, the actual debate about EZ appears quite weird, since whole area CA is almost on balance, while Euro inception increased divergences between member states.

Economic literature have not traced a single cause for external imbalances so far, while different analysis are not consistent with each other in assessing the main drivers of imbalances. [European Commission \[2009\]](#) provided a significant contribution in estimating the impact of each channel on CAs, by arguing that “(c)hanges in domestic demand could account for as much as 40-50% of the differences in current accounts observed in the Euro area since the launch of the Euro”. Among scholars, [Belke & Dreger \[2011\]](#) argued that competitiveness channel is quite robust, hence ULC realignments are required; contrariwise, [Comunale & Hessel \[2013\]](#) argued that financial cycle demand booms may have been more relevant than price competitiveness; moreover, [Gaulier & Vicard \[2012\]](#) did not consider losses in competitiveness as the main cause of deficits, even a symptom of demand shocks: since increasing ULCs could be attributed to rising prices in non-tradable sectors, CA dynamics are not correlated with export performances; finally, [Gabrisch & Staehr \[2012\]](#) suggests that CA deficits would cause relative ULC growth, while not *vice versa*.

Summarily, it is possible to classify the determinants of external imbalances in two distinct groups: the first one refers to *supply-side* factors, while the second one is related to *demand-side* factors<sup>31</sup>. In addition to this, some Northern countries (especially Germany) experienced a peculiar growth model based on export growth and consumption restraints - affecting aggregate demand trend and composition.

##### 4.1 - Supply-side factors: price competitiveness, wages and productivity

Supply-side factors can be clustered into the “competitiveness channel”. In this view, external imbalances are driven by price differentials, since a real appreciation leads to external deficits. According to this approach, a decrease in production costs is required to restore deficit countries price competitiveness: since surplus countries loss of competitiveness is not a feasible strategy in terms of technological regress - even if it could be possible through increasing prices and wages - an asymmetric adjustment across countries (i.e. lower prices in the South) is regarded as necessary in order to reduce imbalances. However, actual inflation in surplus countries is quite low, and it is immediate to note that price competitiveness gains for deficit countries are feasible only by deflation.

---

<sup>31</sup> Certainly, these channels have a different weight across countries with trade deficit. Probably, demand-channel is more relevant for countries experiencing a sustained GDP growth during pre-crisis period (e.g. Spain, Greece), while in countries showing weak income dynamics (such as Italy) supply-channel (i.e. price competitiveness) played a key role.

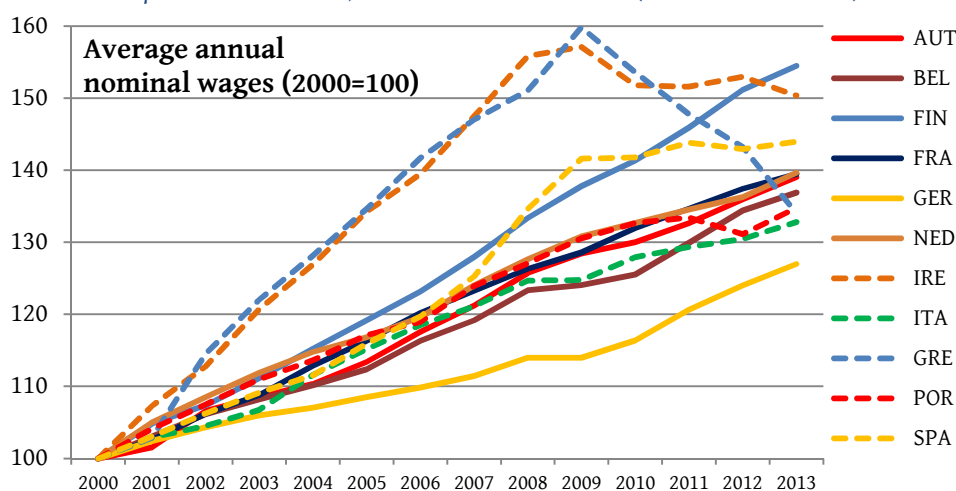
Table 1 – Source: IMF, World Economic Outlook; OECD, Main Economic Indicators

Country	CAB as % of GDP (1999-2010 cum_sum)	ULC annual average growth rate		CPI – annual average growth rate (99-10)
		Total Economy (99-08)	Manufacturing (99-08)	
Austria	22,76	0,71	-0,750	1,76
Belgium	29,4	1,82	-0,322	2,03
Finland	58,03	1,37	-2,420	1,77
France	2,39	1,74	-0,170	1,75
Germany	42,21	-0,06	-0,740	1,55
Netherlands	64,82	2,07	-0,020	2,26
Ireland	-21,66	4,76	0,500	2,91
Italy	-17,94	2,55	1,910	2,27
Greece	-107,05	3,37	1,680	3,12
Portugal	-117,6	2,57	0,990	2,56
Spain	-68,13	3,28	2,988	2,91

As a matter of fact, Northern Europe - and Germany in particular - benefited from low ULC growth and below median inflation rates during the last decade (see Table 1). Then, owing to the common monetary policy, core countries exploited a real exchange rate depreciation compared to the South: these data appear consistent with the hypothesis that external imbalances are driven by wages and labor productivity differentials<sup>32</sup>, which have not been compensated by real exchange rate adjustments.

Following *mainstream* patterns, UE authorities attribute CA imbalances almost exclusively to a lack of competitiveness of deficit countries [European Commission, 2010]. In addition to this, European Commission usually documents price competitiveness differentials by means of REER: some member countries – especially Germany - have seen significant drops in this indicator, while in peripheral countries price indexes rose steeply (see Graph 6). According to policy makers, external imbalances are caused by real exchange rates misalignments: consequently, as adjustment needs to be achieved through internal devaluation, inflation should be lower in Southern countries than in Northern ones.

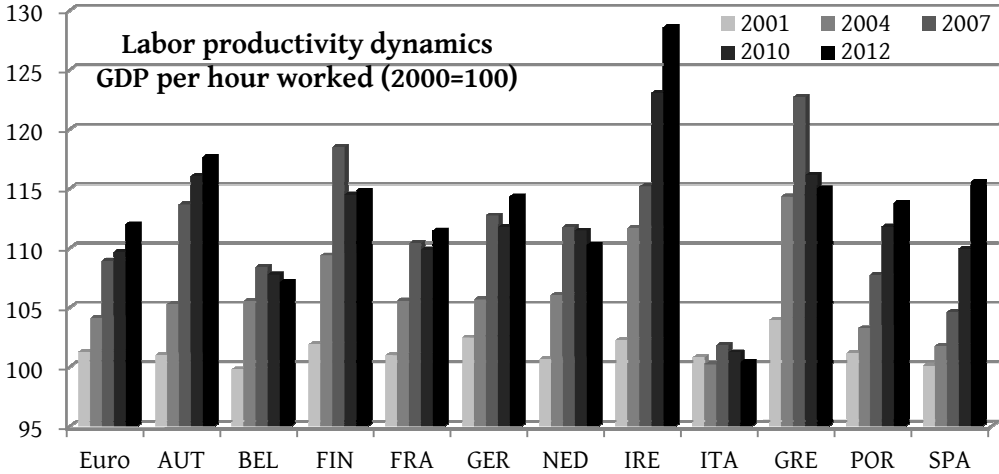
Graph 2 – Source: OECD, Main Economic Indicators (author's elaboration)



<sup>32</sup> As argued in the following section, CA balances are also influenced by different domestic demand patterns. However, Italy and Portugal seems to be peculiar cases: changes in their domestic demand are not strongly related to worsening current account positions. Conversely, this relation is stronger for Ireland, Greece and Spain (see Graph 4).

Furthermore, wage differentials dynamic can be considered as the root cause of imbalances: in this regard, some authors argued that Germany “pursued a policy of aggressive wage restraint (as a means of competitive real devaluation) resulting in large current account surpluses” [Stockhammer, 2011]. According to this view, Northern wages should actually grow more than productivity in order to reabsorb misalignments: this may imply that inflation target will be revised in order to allow core economies to outpace peripheral countries inflation without pushing them into deflation. Several scholars explain Germany export leadership referring to wage moderation (see Graph 2), since ULC dynamic was lower in central countries [Brancaccio, 2011], resulting in a loss of competitiveness for the South. Nevertheless, in the actual framework the burden of the adjustment effectively falls to deficit countries, since the EMU rule book *de facto* provides a low inflation target. This means that peripheral countries are forced to restore their competitiveness through deflation, hence by lowering prices and wages<sup>33</sup>. However, it can be argued that the asymmetry<sup>34</sup> of EU policy system would create a deflationary bias: unless policy makers want to push periphery into a deflationary stagnation, core countries should achieve higher inflation rate than ECB target - obviously, this means correcting EMU rules, and an institutional wage coordination could be the only way to insure a non-deflationary resolution of imbalances.

Graph 3 – Source: Eurostat (author’s elaboration)



Contrariwise, according to policy makers competitiveness differentials can be explained only by low productivity growth in peripheral countries compared to the central ones, since monetary wages seem to converge [Draghi, 2013]. However, before 2007 labor productivity increases were higher in Greece and Ireland than in Germany, while Spain was in line with Euro area average (see Graph 3): this dynamic was linked to real income growth experienced in peripheral countries until global financial crisis. In contrast with these evidences, usually *mainstream* economists - roughly linking productivity dynamics to the competitiveness issue - state that deficit countries show a large scope for (labor) productivity increases

<sup>33</sup> Several traditional policy tools - exchange rate, national monetary or fiscal policy - have been totally given up or hardly restricted in the EMU framework. Hence, flexible labour markets are supposed to be the only transmission channel. Nevertheless, Stockhammer [2011] argued that “wage flexibility has proven incapable of preventing long-lasting divergences in the levels of competitiveness and of current account positions across Europe”.

<sup>34</sup> In this framework, Bagnai [2012a] claims that ECB inflation target is affected by an asymmetry bias because of the absence of a lower minimum. This issue allows countries keeping their inflation rate systematically below other countries one, practicing a real competitive devaluation and consequently a *beggar-thy-neighbour* strategy.

(to be achieved through labour market deregulation), and that *a decrease in nominal wages sounds exotic, but is the same in essence as a successful devaluation; if it can be achieved, it can substantially reduce the unemployment cost of the adjustment* [Blanchard, 2006]. Such argument has been criticized by claiming that wage deflation appears very different from a currency devaluation [Artus, 2011]: internal devaluation can be a very painful process as it can take a long time to restore competitiveness, both owing to wage cuts resistance, and due to lags between decrease in wages and decreases in prices. Finally, countries which would need internal devaluation actually show high debt levels: lower inflation would probably mean deflation, hence increasing debts real value. As a result, increasing public debt-to-GDP ratios could make government bonds markets more nervous, while increasing private debts may cause falls in consumption and investments, as well as increasing troubles in credit market and banking system.

#### 4.2 - Demand-side factors: catching-up and different growth models

In this essay, demand-side factors are interpreted as the consequence of different growth models. In a nutshell, export sectors in surplus countries appeared able to meet increased foreign demand. In line with this view, since EMU inception Germany pursued restrictive wage and fiscal policies, partially “*compensated by a relatively loose policy by the European Central Bank, tailored to the core countries, whose expansionary effects were predominantly felt in the EZ periphery*” [Cesaratto & Stirati, 2011]. In parallel, due to a cheaper access to financial markets (as a result of interest rates downward convergences) peripheral countries experienced both increasing domestic demand and real income growth, combined with nominal wage and price dynamics above EMU average (*credit-led* growth model). This wage trend - rather than a slack productivity growth - led Southern economies to a loss of price competitiveness, while core countries (*export-led* growth model) benefited from periphery aggregate demand expansion [Uxó & al., 2011]. In the meantime, owing to wage moderation core countries have been experiencing a structural weakness of domestic demand combined with weak real growth: probably, without Southern countries imports some core countries (as Germany) might come to stagnation. These different growth models highlighted remarkable divergences across countries in terms of expansion determinants. In credit-led countries, agents financed consumption and housing investments through debt: in this way they provided for great demand to *export-led* countries, which did not experience a rise in private debt because of political choices (e.g. Germany *mercantilism*). The mutual action of these two motions has brought about the actual EZ framework<sup>35</sup>, characterised by real and financial misalignments.

To be fair, also European Commission recognised demand-side factors as a determinant of current account imbalances (see Graph 4), but official reports continuously insist on competitiveness channel<sup>36</sup> - hence, the adjustment shall burden the periphery *via* deflation. However, both domestic demand (which drives import) and external demand (which affects export) played a fundamental role on CAs. Therefore, imbalances may result from different domestic demand trends, and from consequent import dynamics. In this framework, Cesaratto [2010] advanced a possible interpretation of imbalances genesis within EZ, referring to Spain trade *vis-à-vis* Germany: in 2007 Spain exported to Germany 14.4% of its total exports,

---

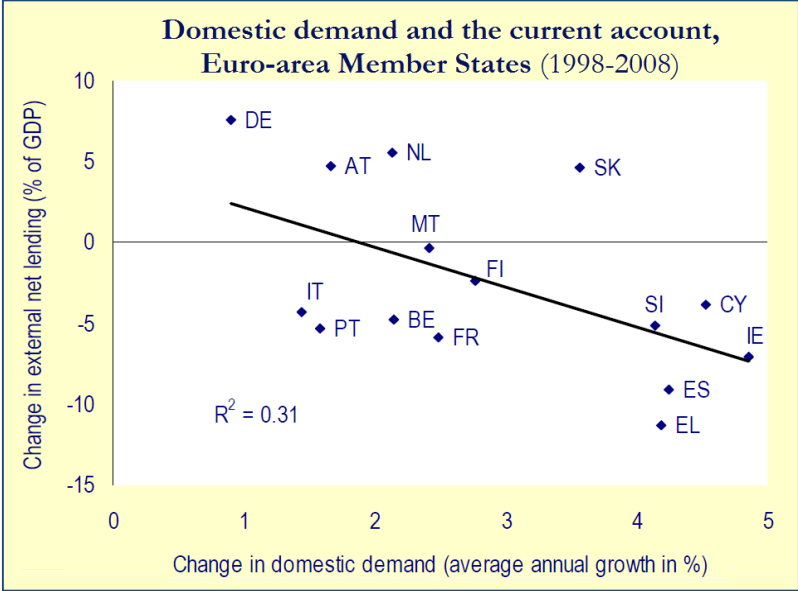
<sup>35</sup> We mainly refer to intra-European economic relations. For a snapshot, in 2006 Germany net exports were for 57% to the EZ, while 54% of Greece negative current account balance results from trade with Euro members (Source: Eurostat).

<sup>36</sup> “(F)oreign demand was the main driver of exports but price competitiveness was key for explaining differences in export performance across Euro-area countries” [European Commission, 2010].



while it imported from Germany 23% of its total import. As a result, Spanish deficit *vis-à-vis* Germany was 49.3% of total external deficit. Hence, it is easily arguable that Spain export performance is targeted towards different markets from Germany, while Spain is an important market outlet for Germany.

Graph 4 – Source: European Commission [2009]



In this debate, other economists identify two structurally different areas (which are based on different growth models), but they conversely argue that EZ suffers from an internal competitiveness problem - rather than a lack of demand [Sinn, 2014]. For these reasons, expansionary fiscal policies would provide for *temporary stimulus and relief, but at the expense of postponing the long-term adjustment that are needed to improve the competitiveness of the crisis-stricken countries*. According to this view, EZ needs austerity measure for the South (where till 2008 a huge inflationary journey was experienced) that will lead to a necessary devaluation: in so doing, deficit countries external competitiveness would be increased. Moreover, this *mainstream* view asserts the simplest solution for imbalances would be *more tolerance towards market forces that are already working in this direction*.

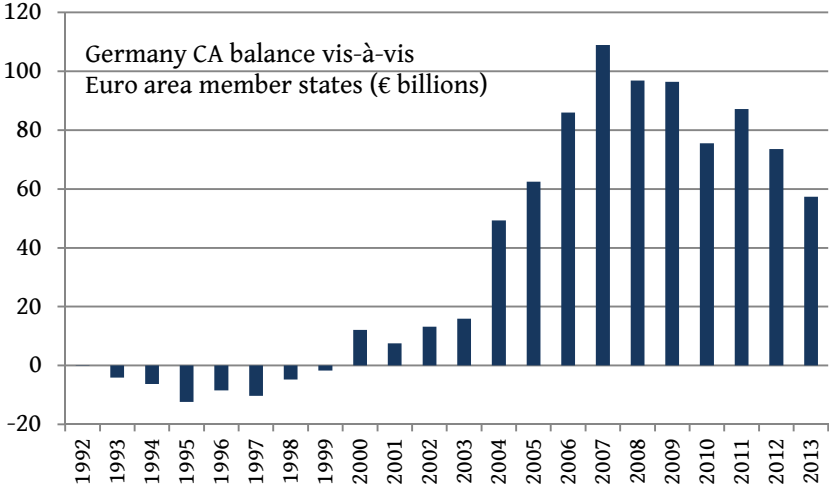
In contrast to this argument, it is possible to claim that strong domestic demand can also have a side-impact on competitiveness through different channels. On the one hand, high domestic demand can obviously lead to growing import (hence, worsening CA deficits); on the other hand, it could affect prices and nominal wages, negatively affecting competitiveness; finally, it can have a positive effect on productivity growth. These phenomena could have been actual in the case of Spain and Greece and, on balance, they could be effective in causing external imbalances [European Commission, 2009].

4.3 - Only external imbalances? A focus on Germany growth model

In the meanwhile, core countries were benefiting from Southern countries *credit-led* growth by running high external surpluses. The main character of this tale was Germany, which after Euro inception moved its CA *vis-à-vis* the EZ from deficit to surplus (see Graph 5). In fact, growing peripheral demand combined with an easier access to international capital markets (due to loose monetary policy) led Southern countries to further indebtedness, while Northern countries were not afraid to finance peripheral

deficits owing to Euro, which mitigated the exchange risk. On these basis, we provide some evidences on Germany growth model in order to show how Germany contributed to imbalances expansion, in order to investigate if German competitiveness is actually related to low domestic demand.

Graph 5 - Source: Deutsche Bundesbank (author's elaboration)



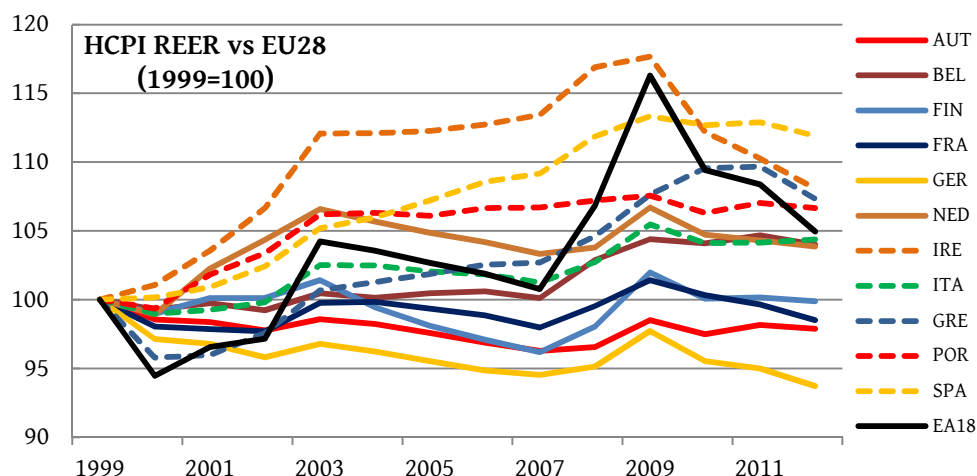
According to data, since Euro inception Germany wage moderation has been quite striking<sup>37</sup>. Nominal wage growth rate has systematically undershoot productivity growth rate, and ULC fell consistently between 2001 and 2007<sup>38</sup>. As a result, Germany experienced a marked decline in REER, a central factor behind the rising share of world exports: put it simply, this issue could be interpreted as a real competitive devaluation. The two key economic factors reflecting Germany external competitiveness were off-shoring and structural reforms. Some authors argue a part of Germany gain in price competitiveness is clearly due to outsourcing: especially, *German firms' offshored part of production to the new member states in Eastern Europe, Russia and Ukraine* [Marin, 2010]. In addition to this, between 2003 and 2005 Germany implemented a significant labour market reform<sup>39</sup> based on Hartz I to IV measures (both wage restraints and reductions of social securities were the crux issues of *Schroeder Agenda 2010*). Owing to the combined effect of these two factors, Germany experienced decreasing households consumption and increasing price competitiveness within a fixed exchange rate system.

<sup>37</sup> Roland Berger, consultant of Merkel's government, argues: "There is not only one way to restore competitiveness: I can only point out the success of Germany reforms, started in 2003 with labor market liberalization, and an increase in real wages lower than productivity growth; this was followed by cutting the social system costs, by raising the retirement age to 67 years, by creating a low wages segment... In order to implement this growth model in Italy, workers must give their consensus - similar to that obtained in Germany in last decade - accompanied by sacrifices, to regain competitiveness at world level. For example, between 2000 and 2010 labor costs per unit of output in Germany rose by 3.9% instead of 32.5% in Italy, and the cost of German products decreased by 18.2% as compared to the other EZ countries" (Corriere della Sera, 4 December 2011).

<sup>38</sup> ILO [2012a] argued: "Under the impression of high and sticky unemployment, the Schroeder Government initiated a series of labour market reforms starting in 2003, effectively reducing entry wages at the lower end of the labour market. Already starting in 2000, several tripartite negotiations had been undertaken in an attempt to lower wage growth and to restore price competitiveness... (M)ost of the reforms essentially led to wage deflation... (L)ittle was done to restore competitiveness through increases in productivity... Indeed, productivity developments remained in line with other euro area countries".

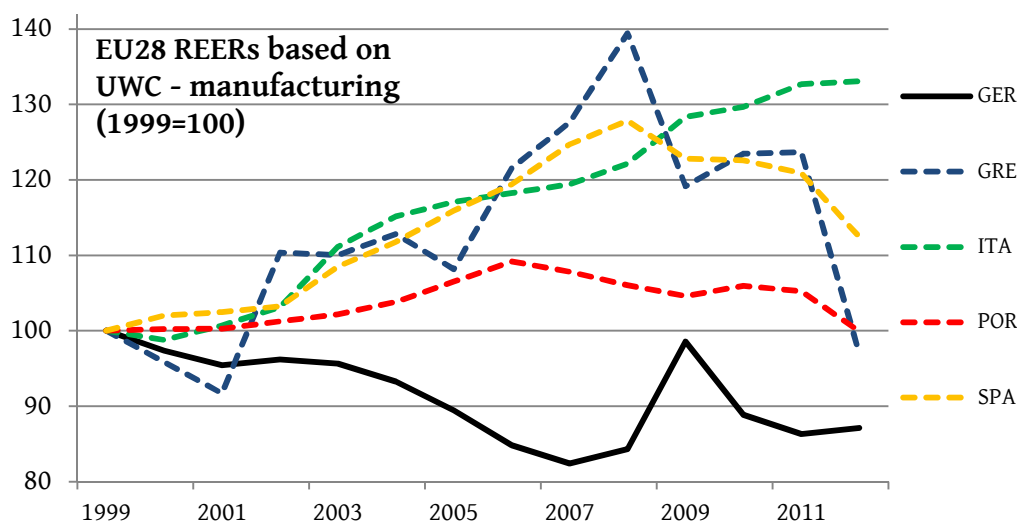
<sup>39</sup> According to Eurostat surveys, in 2012 Germany showed the highest proportion (22,2%) of low income workers within Western Europe. In this regard, Brancaccio [2011] considers this slow wages dynamic as the result of a long series of deep changes in country system about industrial relations: even if Germany was already a surplus economy, wage moderation contributed to increase the gap with deficit countries.

Graph 6 – Source: European Commission, Economic and Financial affairs (author’s elaboration)



Based only on export performances, Germany is actually considered as a super competitive economy. However, as Krugman [1996] suggests, competitiveness should be a *notoriously slippery term* when applied to a country, rather than a firm, while like a firm Germany is defeating its international competitors and gaining an unfair conflict for continental market shares. Germany has also been running an enormous trade surplus extra-EZ: its whole current account balance was 7.5 per cent of GDP in 2013 (in absolute terms the second largest surplus in the world, after China). So, is huge external surplus a reflection of vitality and prowess of the economy? In this regard, we argue a mere export approach could be misleading, since country competitiveness should not be measured only by the size of its trade balance: in that case, competitiveness must mean something quite different from productivity [Whyte, 2010].

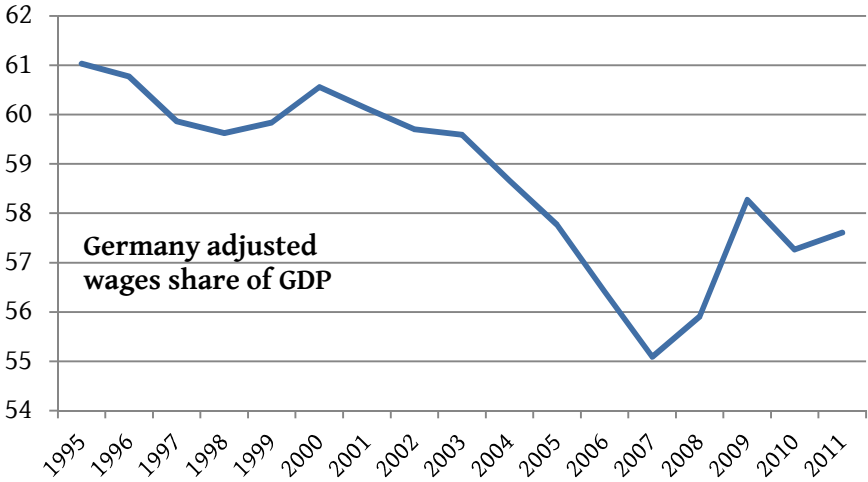
Graph 7 – Source: European Commission, Economic & Financial affairs (author’s elaboration)



According to data, the argument that Germany competitiveness has been fostered by income policies uncoordinated with other Eurozone countries appears relevant. Moreover, intra-EZ imbalances are not just driven by efficiency differentials, as Germany productivity appears quite aligned with EU average (see Graph 3), while wage dynamics are not: according to this argument, Fritsche & Erber [2008] argue *the fact that the German economy has a extraordinary export performance and competitiveness was mainly driven by*

massive wage restraints but is not due to productivity gains. This wage policy resulted in a real devaluation: referring to manufacturing sector<sup>40</sup> (see Graph 7), Germany experienced a strong decrease in REER, while in Southern countries price competitiveness indicators (based on nominal unit wage cost<sup>41</sup>) have drastically grown - in 2012 data showed a 40 base points gap between Italy and Germany, and a generalised differential with all peripheral countries. However, before the outbreak of sovereign debt crisis (2009) Italian REER based on ULC<sup>42</sup> was overvalued by a modest 2% compared to EA17 average - while REER based on HCPI was under EZ median level. Hence, we argue Italian external competitiveness has been in line with European average. Contrariwise, Germany showed a devaluation journey - since in 2003, with labour market reforms - which caused high competitiveness differentials vis-à-vis peripheral countries. Based on available data, we can argue Germany experienced a competitive devaluation (in real terms) of about 20% against Southern countries: if Italian price competitiveness seems to be rather aligned to European average levels, there is a sharp gap with its main competitor due to German behaviour<sup>43</sup>. Also [European Commission \[2010\]](#) recognized this evidence: “if Italy’s real exchange rates had evolved in a similar way to Germany’s since the beginning of 1999, Italy’s export growth would have almost matched that of Germany’s, while in reality it was less than one third its size”.

Graph 8 – Source: International Labour Organization



Since currency devaluation is unfeasible in the EZ, accumulation of external debt was a logical consequence. In parallel, Northern countries were able to run huge external surpluses, and they used them to finance peripheral countries deficits. However, *mainstream* argument goes as follows: i) CA surpluses reflect price competitiveness, while deficits mean lack of competitiveness; ii) the fall in interest

<sup>40</sup> With regard to manufacturing sector, [Nocella \[2015\]](#) observed a negative relationship between Germany labour share and export contribution to GDP (wage share deviations from average explain 68% export share variability). Moreover, wage share is more variable (1991/2007) in Germany than in Italy, USA and France.

<sup>41</sup> From 2001 to 2007 (pre-crisis period), German nominal wages in the manufacturing sector grew at 1,8% average annual rate, far below Italy (3%), France (3.5%), Spain and Portugal (5.3%) (Source: *OECD Stats*).

<sup>42</sup> To be fair, recent ULC data are affected by a decreasing productivity, due to under-utilisation of output capacity.

<sup>43</sup> In order to demonstrate Italian external competitiveness is not compromised, it is useful to analyse trade balances distinguishing in trade within and outside European Union. Regarding the intra-EU27 trade performances, during the period 1999/2012 Italy was essentially breakeven. On the contrary, in 1999 Italy exported to extra-EU27 countries 7,02% of its GDP, while in 2012 this share was of 11,52%. Nevertheless, if at the beginning of the 2000s Italy ran little CA surpluses, since 2005 imports were greater than exports, except for 2012 (Source: *Ameco*).

rates caused by EMU led to unsustainable booms in borrowing and domestic demand in Southern countries, fuelling inflation and raising relative prices within EZ [Bayoumi & al., 2011]; iii) deficit countries must adjust through internal deflation. By contrast, we argue this view appears disputable as it ignores the contribution that peripheral countries had provided to Northern countries foreign demand. Moreover, it does not consider that Northern countries increases in net exports express a sizeable stagnation of domestic demand, caused by wage compression and high savings [Simonazzi & al., 2013]. Then, Germany has been able to run an economy with *chronically weak demand* and persistent external surpluses owing to others European countries have been the polar opposite<sup>44</sup> [Whyte, 2010; Cesaratto & Stirati, 2011]. In this regard, even European Commission [2010] stated that *weakness in domestic demand has been the central driver of the downshift in imports and increasing current account surpluses*, also related to *the share of wages in GDP has been falling significantly in the Euro area as a whole; however, the fall has been significantly more marked in Germany and Austria than in the euro area as a whole* (see Graph 8). These elements appear consistent with high German propensity to save - since Euro inception systematically 3% above EMU average - depending on increasing firms profits due to wage moderation.

Table 2 – Source: Ameco time series at 2005 market prices (author’s elaboration)

<b>3.1) Average ‘80-13</b>	<b>C</b>	<b>G</b>	<b>I</b>	<b>X</b>	<b>M</b>	<b>NX</b>	<b>GDP</b>
Growth rate	0,0194	0,0184	0,0186	0,0510	0,0482		
Share on GDP	0,5859	0,1941	0,1825	0,3183	0,2808		
Growth contribution	0,0113	0,0036	0,0034	0,0162	- 0,0135		2,10%
% growth contribution	54,00%	17,03%	16,15%	77,33%	-64,50%	12,82%	100,00%
<b>3.2) Average ‘80-98</b>	<b>C</b>	<b>G</b>	<b>I</b>	<b>X</b>	<b>M</b>	<b>NX</b>	<b>GDP</b>
Growth rate	0,0277	0,0243	0,0282	0,0446	0,0473		
Share on GDP	0,5895	0,1976	0,1841	0,2366	0,2078		
Growth contribution	0,0163	0,0048	0,0052	0,0106	- 0,0098		2,70%
% growth contribution	60,32%	17,74%	19,22%	39,05%	-36,33%	2,72%	100,00%
<b>3.3) Average ‘99-13</b>	<b>C</b>	<b>G</b>	<b>I</b>	<b>X</b>	<b>M</b>	<b>NX</b>	<b>GDP</b>
Growth rate	0,0088	0,0110	0,0063	0,0591	0,0494		
Share on GDP	0,5813	0,1897	0,1805	0,4218	0,3733		
Growth contribution	0,0051	0,0021	0,0011	0,0249	- 0,0185		1,48%
% growth contribution	34,57%	14,10%	7,71%	168,1%	-124,5%	43,62%	100,00%

In order to recognize if Germany really experienced weak internal demand, Table 2 provides evidence about different contributions to its real GDP growth over time. Referring to the period 1980/2013 (3.1) data show a 2,10% average annual real growth rate, which is more than half (54%) due to households consumption dynamic (C), and only 12% due to net export pace (NX = X-M). However, if we split the analysis in two sub-periods we can immediately observe a sharp change in real growth contributions.

Before EMU (3.2) average annual real growth rate was 2,70%, supported for 60,32% by consumption and for 2,72% by net export. After 1999 (3.3), Germany has been experiencing a lower average annual real growth rate (1,48%): GDP dynamic depends on consumption for 34,57%, while net export contribution is 43,62%. According to these data, we argue weak domestic demand has played a key role in increasing CA surpluses. In addition to this, we can also state external competitiveness has benefited from currency

<sup>44</sup> For a snapshot on European trade, it is useful to point out that in recent years, at the Intra-EU\_27 level, the amount of imports was almost perfectly aligned with export. Export €: 2009, 2.198.406; 2010, 2.541.357; 2011, 2.806.258; 2012, 2.828.853 – Import €: 2009, 2.133.441; 2010, 2.470.714; 2011, 2.740.048; 2012, 2.757.475 (Source: Eurostat).

union, given the definite change in net export contribution to real growth. Furthermore, investment-to-GDP ratios are quite constant overtime<sup>45</sup> (about 18%), then we can assert external competitiveness is not mainly due to peculiar investments (I), but it has been achieved through cost factors, i.e. labour costs<sup>46</sup> and a low real exchange rate.

In addition to wage policy, also fiscal policy was crucial in implementing this growth model. During the early 2000s Germany experienced low income growth rates and high unemployment (about 10%), combined with growing public debt-to-GDP ratios<sup>47</sup> as a result of government primary net deficits. According to [Bagnai \[2012b\]](#), expansionary fiscal policies were aimed to finance labour market deregulation through subsidies to workers damaged by *Hartz* reforms: these policies had put down real wages by about 6%. Indeed, public deficit was not due to lower revenues, while to higher expenditure<sup>48</sup> on firms subsidies and on active policies in the labour market were relevant. Moreover, low households consumption (due to wage moderation) allowed Germany to achieve an *export-led growth model*, which in few years would contribute to reduce unemployment as a consequence of increasing foreign demand. In the meanwhile, other EZ countries (especially Ireland, Spain and Italy from 2000 to 2007) were achieving the required fiscal consolidation through public primary net surpluses. At a later time, Germany opted for a sharp policy change, by achieving restrictive fiscal measures since 2006. However, this appears in contrast with *Maastricht Treaty*, which imposes national fiscal policies coordination.

#### 4.4 - Adjusting external imbalances

Evidences we provided suggest that EZ crisis has not been caused by peripheral countries fiscal indiscipline, while persistent external imbalances (caused by price differentials and demand dynamics) which have not been offset by real exchange rates adjustments might played a key role. In addition to this, the crisis exposed the structural fragility of the EZ, which does not allow countries burdened with external imbalances to exploit redistributive fiscal policies between surplus and deficit countries. Owing to this lack combined with a peculiar institutional framework (especially, the absence of ECB interventions), EMU was not immune from speculative attacks caused by persistent external imbalances. To avoid it, some authors claim that external adjustment should occur through internal revaluation in surplus countries, that is through *a nice little inflation in Germany... and an expansion of its domestic demand* [[Cesaratto & Stirati, 2011](#)], i.e. higher prices and wages in Northern countries [[Brancaccio, 2011](#)]. Wage increases in the North would reduce imbalances both through inflation (lower price competitiveness) and through changes in income distributions (i.e. lowering profits would increase aggregate demand and consequently import, due to the propensity to consume is higher for wage earners). According to other

---

<sup>45</sup> To be fair, this data could also reflect high FDIs required by off-shoring processes.

<sup>46</sup> [Lestrade \[2010\]](#) refers to *wage dumping* in order to be competitive. In addition to atypical contracts boost, Germany is today a two-tier society, with a dual labour market: apart from export-oriented employment, several workers are now in precarious conditions, with no minimum wage and no health insurance. Moreover, [Murer \[2012\]](#) estimates a 15% German unemployment rate (instead of an official 7%), making appropriate corrections based on temporary workers and cumulative job contracts. As a matter of fact, labour market deregulation provided for the implementation of both *mini-jobs* (400 Euros per month part-time agreements) and *1 Euro-jobs*, usually for services, paid one Euro per hour.

<sup>47</sup> Germany general government gross debt (% of GDP): 2001, 59.1; 2002, 60.7; 2003, 64.4; 2004, 66.2; 2005, 68.5; Germany general government primary net lending/borrowing (% of GDP): 2001, -0.5; 2002, -1.3; 2003, -1.5; 2004, -1.2; 2005, -0.9 (Source: *IMF, World Economic Outlook*).

<sup>48</sup> Germany general government revenue-expenditure (billion): 2000, 946.64-923.36; 2001, 936.13-1000.78; 2002, 940.32-1022.33; 2003, 951.58-1040.72 (Source: *IMF, World Economic Outlook*). According to [Bagnai \[2012b\]](#), about two-thirds of additional (2000/2003) government expenditure represented direct or indirect subsidies to the industrial system.

authors [Mayer, 2011] an intermediate solution could be accomplished given peripheral countries troubles in achieving internal devaluation: in so doing, the adjustment burden would be shared with surplus countries, especially during slowdowns. Then, a proper solution to imbalances could be a stronger demand in surplus countries instead of a weaker demand in deficit countries [Keynes, 1943]. Contrariwise, actually Northern countries are not willing to accept sharing views. By contrast, they impose fiscal austerity, expecting periphery deflation - hence, this mechanism should restore South competitiveness<sup>49</sup>.

Nevertheless, deflation will be effective only in case wage restraints will cause an equivalent fall in prices: otherwise, it will affect only income distribution. In this regard, several analysis [Artus, 2011; Levrero, 2012; Papadimitriou & al., 2013a] show a remarkable scepticism about restrictive policies effectiveness: even if these measures would rebalance CAs via increasing deficit countries price competitiveness, the cost of the adjustments would be vast<sup>50</sup> - in terms income loss, debt burden and living standards - unless its burden was shared by surplus countries through suitable policies of aggregate demand expansion. According to these arguments we consider the causal connection between austerity and competitiveness as quite dangerous.

## 5. Austerity effectiveness on external imbalances

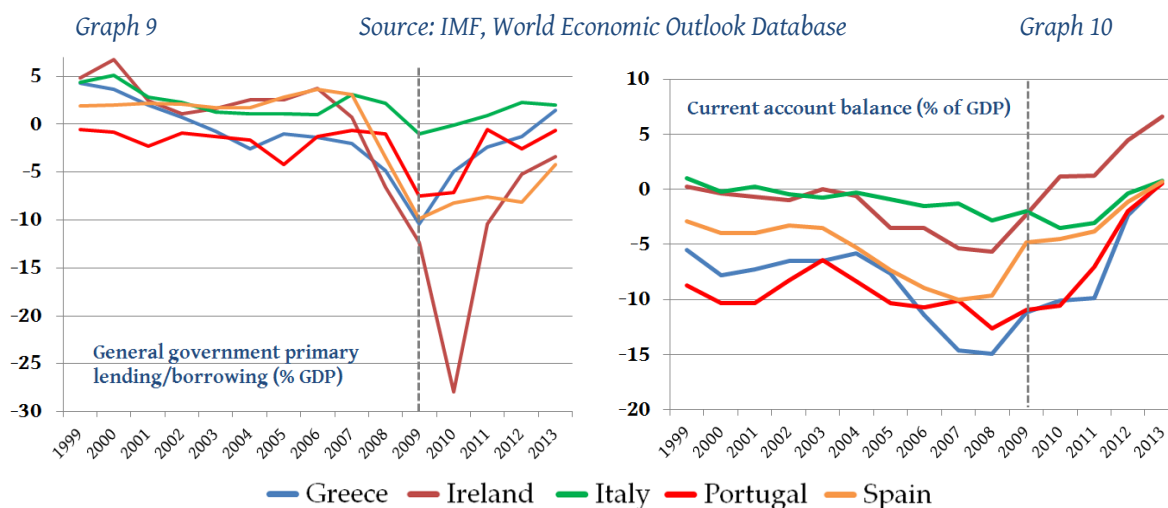
As argued, *competitive austerity* was the main driver of policy makers: up until now, GIIPS countries are expected to deflate in order to restore price competitiveness - although restrictive policies dramatically contain real growth. From preliminary analysis, we can argue austerity policies have actually affected CA misalignments. Put it simply, if these measures were aimed to reduce external imbalances, macroeconomic evidence clearly show that fiscal consolidation (i.e. reducing deficit-to-GDP ratio) achieved by GIIPS countries since 2009 (see Graph 9) was combined with a progressive recovery of their current accounts (see Graph 10). Moreover, according to data all EMU members undergoing austerity achieved a positive CA during 2013, while we can observe a generalised decrease of Eurozone trade imbalances<sup>51</sup> since 2009. However, we consider these evidences as insufficient to endorse the *competitive austerity* perspective.

---

<sup>49</sup> Mainstream arguments do not consider the hypothesis of a substantial sharing of the adjustment burden. Alesina & Perotti [2010] argue: “The constraint on European growth is not Germany’s fiscal policy. It is the supply side rigidities that riddle all European national economies - especially those of southern European countries. To obsess about the demand side is simply misplaced - a slightly outdated, and oversimplified Keynesianism. Perhaps supply side reforms are unfeasible, but that should not lead us to fool each other that a German budget deficit of 5% instead of 3% of GDP will take Europe out of its predicament”. In this framework, Dadush & Stancil [2011] argue: “an extended period of austerity (fiscal consolidation, increased household savings, corporate and bank deleveraging) could lower prices and wages in the periphery, thereby re-establishing competitiveness”. Moreover, J.P. Morgan [2013] referred to fiscal and competitiveness adjustments with a clear focus on sovereign deleveraging, real exchange rate adjustment, household and bank deleveraging, structural and political reforms. We consider all these issues as consistent with our arguments of both *expansionary* and *competitive* austerity, based on a *structural adjustment* which according to J.P. Morgan is feasible with political and constitutional reforms: in this essay peripheral countries Constitutions are considered as constraining for governments’ reform agendas.

<sup>50</sup> Referring to austerity policies costs, Kaldor [1971] argued: “Monetary union and Community control over budgets will prevent a member country from pursuing full employment policies on its own - from taking steps to offset any sharp decline in the level of its production and employment, but without the benefit of a strong Community government which would shield its inhabitants from its worst consequences”.

<sup>51</sup> Data about *net incomes* and *net current transfers* are not available, then we refer only to trade balances.



However, we critically discuss this view by means of additional macroeconomic evidences (Table 3). Especially, wages dynamic and inflation rate can be used to investigate how nominal wage trend has already affected consumer prices: according to data, wage moderation in GIIPS countries did not have an immediate effect on prices - hence, austerity measures led to decreasing real wages. In parallel, we observe a growing unemployment rate combined with a progressive labour market “flexibilisation”: in other words, data suggest that employment was not related to the labour market deregulation<sup>52</sup>.

Table 3 – Source: author's elaboration on OECD.Stats database

Nominal wages (growth %)	2009	2010	2011	2012	2013	2014	2015
GREECE	5,81	-4,15	-2,49	-3,21	-6,74	-0,78	
IRELAND	0,86	-3,40	1,32	0,85	1,32	2,87	
ITALY	0,10	2,38	1,33	-0,38	1,17	1,19	
PORTUGAL	2,76	1,74	-1,40	-2,45	3,07	-1,32	
SPAIN	5,35	-0,50	0,70	-0,33	1,44	-0,31	

Consumer Price (growth %)	2009	2010	2011	2012	2013	2014	2015
GREECE	1,2	4,7	3,3	1,5	-0,9	-1,3	-1,7
IRELAND	-4,5	-0,9	2,6	1,7	0,5	0,2	-0,3
ITALY	0,8	1,5	2,8	3	1,2	0,2	0,0
PORTUGAL	0,8	1,4	3,7	2,8	0,3	-0,3	0,5
SPAIN	0,3	1,8	3,2	2,4	1,4	-0,2	-0,5

Unemployment rate 15-64 (%)	2009	2010	2011	2012	2013	2014	2015
GREECE	9,8	12,9	18,1	24,7	27,7	26,7	25,1
IRELAND	12,5	14,1	14,9	15,3	14,1	12,1	10,0
ITALY	7,9	8,5	8,5	10,8	12,3	12,9	12,1
PORTUGAL	10,0	11,4	13,3	16,3	17,0	14,5	12,9
SPAIN	18,0	20,0	21,5	24,9	26,2	24,6	22,2

EPL index	1999	2008	2009	2010	2011	2012	2013
GREECE	2,80	2,80	2,80	2,80	2,17	2,17	2,12
IRELAND	1,44	1,27	1,27	1,27	1,27	1,40	1,40
ITALY	2,76	2,76	2,76	2,76	2,76	2,76	2,51
PORTUGAL	4,58	4,42	4,42	4,13	4,13	3,56	3,18
SPAIN	2,36	2,36	2,36	2,36	2,21	2,21	2,05

<sup>52</sup> EPL index is one of the more frequently used measures of the strictness of the “Employment Protection Legislation” in different country. We provide EPL index for regular contracts, while OECD calculates it also for temporary contracts.



Hereafter we are going to explore to what extent channels we already identified (increasing export and decreasing import) have actually contributed to CAs realignment: to this regard, we therefore proceed on a case-by-case basis in order to detect how *competitive austerity* actually reduced CA imbalances.

### 5.1 - Greece

In May 2010, Greek government received a 110 billion Euro three-years institutional loan. Furthermore, Greece arranged cuts in public expenditure and privatisation measures in order to obtain further loans from the ECB and IMF. In 2011 international agencies cut Greece's rating, leading to great troubles in debt refinancing. Then, after Greek Parliament approved an additional austerity plan, EU provided for further rescue loans throughout 2011. Despite wage lowering, Greece was not experiencing an export-led recovery: according to data, exports to EZ as well as total exports are not significantly increased after the adjustment program, whilst imports fell by half from 2008 to 2013. However, in 2013 Greece achieved a balanced CA: this realignment was achieved only through import compression. According to *mainstream* literature, Greece is still showing difficulties in implementing the adjustment program, especially a lack of export growth. Hence, in order not to assert wage deflation was unable to restore competitiveness, scholars of the *conventional* economic literature argued that “*Greek economy has remained so distorted that it has not responded to changing price signals ... the facile argument that Greece has little to export is irrelevant here, and the problem is not that Greek exports are low, but rather that they have failed to grow, which should have been possible, especially from a low base*” [Gros, 2014]. However, austerity policies have been devastating for Greece: real GDP fell by 25% relative to 2007, and in this regard Zezza [2014] argued that “*when capacity is reduced by a shock comparable to that of a war, it is hardly surprising that the exporting capacity is compromised as well*”. Moreover, export represents a small GDP share, and price elasticity estimated by Papadimitriou & al. [2013b] are very low: it means that exports growth through wage deflation will take a long time, and may even generate a fall in export revenues as long as the volume of exports does not grow sufficiently to outweigh the fall in prices. As a result, Greek economy is not supposed to recover from export.

### 5.2 - Ireland

From 2009 to 2013 Ireland government approved seven economic reforms - based on public expenditure cuts - in order to obtain a 67,5 billion Euro institutional loan in 2010. Financial assistance was aimed to finance 2009 public deficit, largely due to bank bailouts. However, the Irish case is undoubtedly the most puzzling among EMU: Ireland has never experienced trade deficit, both globally and *vis-à-vis* EZ, while it was still forced to pay huge capital incomes abroad because of the establishment of multinational companies as a consequence of a kindly tax regime. In this regard, the rapid growth of Irish economy was due to large foreign investment inflows fostered by low tax rates on business income. Hence, foreign capital flows directly financed Irish investments made by foreign companies. Obviously, FDI must be remunerated (i.e. foreign entrepreneur implants a productive activity in order to get profits). Then, these profits could be either spent in that country or collected by the investor in the residence country. In the latter case, national account considers repatriated profits as foreign passive incomes, which remunerate the original debt contracting with FDI. Data clearly show that net incomes (NY) instead of trade balance have been leading CA to deficits since 2009: To this regard, Bagnai [2010] showed that since 1992 to 2006 (i.e. since financial integration in EZ till the outbreak of financial crisis) average capital

income paid from Ireland to the rest of the world was 32% of its GDP, while 6% on average in other EZ countries. In addition to this, Ireland experienced a decreasing debt-to-GDP ratio owing to real growth, and this represented an outstanding guarantee for foreign investors. Afterwards, CA surpluses *vis-à-vis* all countries of the world don't depend on higher export of goods, but on declining imports compared to the pre-crisis period. In light of this analysis, we conclude that austerity does not lead to export growth.

### 5.3 - Italy

In November 2011 Italy experienced the highest credit spreads on sovereign debt, combined with a government crisis. Following *Troika* recommendation letter (5<sup>th</sup> August 2011), the new Monti government pursued austerity measures - considered as “essentials” - based on increasing taxes, labour market deregulation, interventions in the pension system, reduction of public employees cost, local governments unifications and liberalisation programmes<sup>53</sup>. In addition to this, a Constitutional reform tightening fiscal rules (i.e. balanced budget from 2015) was approved. However, Italy has not been forced to austerity because of huge CA deficits - trade balance is substantially balanced overtime - but rather as a counterpart to the ECB intervention on government bonds secondary market owing to high credit spreads. Recently, Italian policy focus was shifted on “structural reforms”, intended as *reforms aimed at cutting pension payments to generate a structural reduction in the government deficit and increasing flexibility in the labor market*. As a matter of fact, Italy has been experiencing increasing unemployment since 2007, even if new part-time workers are increasing too. Both structural reforms (e.g. 2011 pension reform) and austerity plans fostered unemployment rate, while increased competitiveness achieved through lower labour costs seems to be unable to improve external balance. In parallel, some authors argue austerity contributed to a dramatic drop in domestic demand [Zezza, 2013]. Moreover, increasing CA does not depend on higher exports to EZ: trade balance increased since Italy, even exploiting Euro depreciation against Dollar, was experiencing export growth outside EZ - exports are exceeding pre-crisis levels.

### 5.4 - Portugal

In May 2011 Portugal government got a 78 billion institutional loan. As a condition to financial support Passos Coelho government decided for a reduction in company costs through a sharp cut in wages, even by proposing cuts on social-security contributions. By reducing labour costs, policy makers hoped to push down prices and to increase Portugal's export competitiveness. In addition to this, the adjustment program signed by Portugal government with the European Commission in order to obtain loan provided for the privatisation of major public enterprises. In “Portugal Memorandum of Economic and Financial Policies” we find typical propositions as “*a special contribution levied on pensions above €1,500 will be introduced in 2012*”, “*5% cut in nominal public sector wages and the freezing of pensions in 2011*”, “*reduce costs in area of education*”. Reductions of collective bargaining protective legislation were also required. Moreover, in recent years the national postal service as well as the freight company were privatised,

---

<sup>53</sup> From 2010 to 2012 austerity policies have been implemented in Italy by means of several measures: Financial Act 2010, Stability Law 2011, Stability Law 2012, Stability Bill 2013, D.L. n. 201/2011 (*Salva-Italia*, “*Disposizioni urgenti per la crescita, l'equità e il consolidamento dei conti pubblici*”), D.L. n. 87/2011 (“*Misure urgenti in materia di efficientamento, valorizzazione e dismissione del patrimonio pubblico, di razionalizzazione dell'amministrazione economico-finanziaria, nonché misure di rafforzamento del patrimonio delle imprese del settore bancario*”), D.L. n. 152/2012, converted into Law 94/2012 (*Spending Review*, “*Disposizioni urgenti per la razionalizzazione della spesa pubblica*”), D.L. n. 95/2012 (*Spending Review 2*, “*Riduzione della spesa a servizi invariati*”).

while the main public energy company has been acquired by foreign investors. With respect to fiscal policies, taxes were the main tool to get a balanced budget: according to OECD, Portugal has reached a record 47% tax burden. Besides, in Portugal we observe also a huge contraction of internal demand, resource reallocation towards export-oriented sectors and tourism, and the creation of a temporary labour market with poor rights to workers. A strict focus on export channel raises the competitiveness issue: however, given negative net investments, the only way to increase competitiveness is through wage reduction and/or extending working hours. As a result, export growth has been achieved both inside EZ and globally, while CA has become modestly positive in 2013 owing to trade balance increases.

#### 5.5 - Spain

In June 2009 Spanish government undertook a bank bailout program (FROB, *Fondo de reestructuración ordenada bancaria*) that would have received a 100 billion institutional loan through EFSF. FROB conveyed such resources to troubled banks, while Rajoy government introduced austerity measures including cuts to ministries and local governments budgets, privatisation programmes, higher taxes (both income and corporate) as well as spending reviews in education and health. Austerity package approved in July 2012 was 65 billion, including increasing VAT, cuts on Parliament employees and the elimination of civil servants Christmas bonus. In addition, public employees vacation days and union permits were reduced. According to data, since 2009 Spain has been achieving an export-led recovery supported by declining ULCs, combined with labour market reforms (government made dismissals easier by halving firing costs) and high unemployment rate (about 25%). Indeed, export growth has been experienced both inside and outside the EZ. As a result, CA has become positive in 2013 owing to trade balance switched from negative to positive since 2012 as a whole and since 2011 *vis-à-vis* EZ. However, owing to cuts in wages and high unemployment Spain domestic demand is dramatically falling. In this framework, both overall poverty rate (28% in 2014) and youth unemployment rate (55% in 2014) are alarming data.

#### 5.6 – General considerations about imbalances realignment

In this section we considered the impact of austerity policies on CA balances by means of a country specific analysis: especially, we used macroeconomic evidences and we listed some relevant measures for competitive austerity implementation. Through this survey we can assert that restrictive policies in deficit countries, which are decisively connected to CA realignments, are crucially related to specific policy orientations based on an asymmetric adjustment of imbalances. As a matter of fact, competitive austerity mainly concerned i) the restraint of deficit country growth in order to lower import (the more relevant transmission channel) and ii) the process of internal devaluation to foster export (which only in few cases have actually been experienced). However, austerity in deficit countries definitively affected domestic demand and productive system, with a consequent negative impact on employment.

### **6. Austerity side-effects from a Keynesian perspective**

In previous sections we analysed how *competitive austerity* - based on a confined theoretical framework - have been actually implemented in GIIPS countries, by highlighting feasible transmission channels and

evaluating their impact on CA imbalances. It has become apparent that *competitive austerity* is consistent with an asymmetric-deflationary adjustment (based on fiscal strictness and wages/prices flexibility), by means of policies that concerned deficit countries growth (to curb imports) and internal devaluation (to foster export). However, these measures negatively affected internal demand with poor substitution effects - which are typical of currency devaluations - between domestic and foreign goods. Moreover, by containing aggregate demand such policies dramatically affected productive structures: these side-effects involve also social issues due to the fact that high unemployment is combined with a weaker welfare system recommended by policy. Finally, austerity did not yet lead to fiscal consolidation. Following Keynesian arguments, in this section we emphasize restrictive fiscal policies effects on output, employment and debt-to-GDP ratio, by providing both theoretical arguments and empirical evidences in order to disprove the link between austerity and competitiveness suggested by policy measures.

### 6.1 - The relationship between restrictive policies and private investment

Both *expansionary* and *competitive* austerity appear questionable if we analyse them from an alternative theoretical perspective. Basically, the idea that fiscal consolidation may stimulate private expenditure (mainly investments) both through a lower interest rate and by boosting investors confidence contradicts the usual Keynesian view that higher taxes (or lower public expenditure) may have contractionary effects - amplified by the Keynesian multiplier - on aggregate demand, then on output.

In addition to this, crowding-out could be considered as a controversial thesis, since it is subject to a twofold critique. Firstly, investment decisions by private firms do not depend solely on interest rates, since they are deeply influenced by entrepreneurs expectations about expected demand. To this regard, the inverse relationship between investments and interest rate - central to the mainstream view<sup>54</sup> - is not only criticized from a theoretical perspective by *non conventional* economists [Garegnani, 1979], since aggregate and firm level data show that it does not occur<sup>55</sup> [Chirinko, 1993] - hence, some authors argued *the empirical evidence on the sensitivity of investment to interest rates is, at best, equivocal* [Blinder, 1997]. Secondly, public and private spending can be considered as interconnected: private investments can grow because public expenditure will increase expected sales (i.e. government spending will boost demand for goods, which in turn will increase demand for new private output resources), and since government expenditure will also provide more favourable economic conditions (e.g. improvement of infrastructures). In this perspective, fiscal restraints would reduce public and private investments which in contrast can favour efficiency and competitiveness, especially in deficit countries.

### 6.2 - Wage deflation effects on aggregate demand

With respect to disinflation policies to foster deficit countries competitiveness by means of wage deflation it is useful, for sake of simplicity, to distinguish two cases: in the first one, we consider that wage decreases would be followed by an immediate and equivalent reduction in prices; in the second one, we more likely consider that this mechanism would not be straightway (i.e. prices are usually sticky,

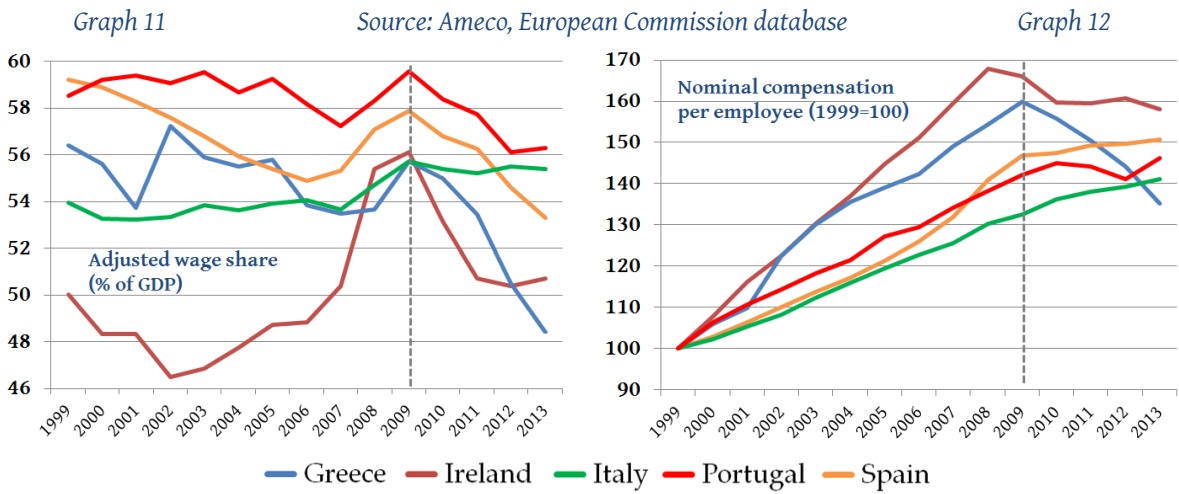
---

<sup>54</sup> By contrast, according to Keynesian arguments (often supported by empirical evidences) investment decision are mainly based on expected demand, with a secondary role of interest rate. However, deflation (i.e. negative inflation) would increase real interest rate: this in turn could depress investment and, *via* aggregate demand, also real income.

<sup>55</sup> A recent Krugman [2014] proposition seems to reinforce this hypothesis: “*one of the dirty little secrets of monetary policy is that it normally works through housing, with little direct impact on business investment*”.

then they would not promptly react to wage adjustment). On these basis, we can argue that in the first scenario real wages would be not modified, while in the second one income redistribution would be experienced.

Even in case of constant real wages we argue that nominal wage moderation in the actual EZ framework (characterized by zero inflation) might lead to deflation: negative inflation would increase debt burden as well as induce agents to postpone consumption. For these reasons, competitive austerity is able to reduce consumption even without change income distribution: lower households expenditure combined with lower public expenditure will dramatically affect aggregate demand and then total output, and this in turn would negatively affect investment - since it is largely endogenous. Furthermore, in a wage-led system, even in case of perfect transmission, decrease of internal demand can outweigh export growth [Stockhammer & Onaran, 2012].



However, the second scenario appears more feasible<sup>56</sup> since the first one could be realized only in case of perfect competition. By contrast, there is no assurance that 5% wages reduction would lead to an immediate 5% prices decrease: if it would not happen, even the “competitiveness effect” would be confined, while income distribution will change in favour of profits. Of course, real wage reduction can occur also in case of adjustment delay. Within an alternative theoretical framework, it can be argued that such redistribution will depress economy owing to the different propensities to consume of profit and wage earners [Kalecki, 1954; Kaldor, 1966]: especially in the EZ framework, redistribution (see Graph 12) seems to affect private consumption and hence total income.

Summing up, we can argue that “competitiveness effect” linked to wage moderation can partially fail due to rigidities in transmission: this scenario is consistent with real wage reduction, and the subsequent redistribution in favour of profits would cause a fall in aggregate demand [Brancaccio, 2011]. Moreover, wage deflation would have no effect in case this strategy was pursued by all EMU countries: in this case, such a wage dispute would lead to a generalized contraction of EZ activities. Last but not least, the “growth by exports” argument can be criticized in light of the actual weakness of global demand.

<sup>56</sup> According to data (see Table 3), this might be actually occurred: in peripheral countries, nominal wage moderation affected price levels only some years later. Extending the analysis of this trend, from 2002 to 2009 nominal wages in Italy grew more than in other peripheral countries: however, real wages seem don't show an increasing trend owing to high inflation rate in *non-tradable* sectors (services and utilities).

According to EMU policy maker, labour market deregulation - combined with a poor interference of governments - will preserve market equilibrium leading to full employment. For these reasons, structural reforms are required in order to compete in the global trade. However, we point out that a large share of import/export flows of EMU countries involves trade with European partners, hence an export-led model can't be generalized: in case some countries would experience surpluses, other ones will experience deficits. Consequently, wage moderation in the EZ framework, combined with fiscal austerity, will result in a continental weakness of aggregate demand.

To this regard, we note that wage moderation policies - which are actually implemented in the periphery in order to fill the competitiveness gap with core countries - were previously pursued in surplus countries in order to transfer employment troubles abroad. For instance, after a decade of low growth and high unemployment (9.7 in 1997) Germany opted for a clear growth model, based on social agreements between trade unions and firms [Brancaccio, 2011]: as a consequence, wage dynamic became quite low, especially compared to other EZ countries, and this allowed Germany firms to compete on international market - exploiting fixed exchange rate - leading to a sharp change in CA balance<sup>57</sup>. In other words, Germany surplus meant unemployment issues in other EZ countries, which are actually required to reply with the same recipe (see Graph 11). On these basis, austerity is not to be interpreted as consolidation, while it means transfer on workers the burden on external adjustment, as competitive austerity would disappear as soon as competitor countries implement the same strategy of wage moderation. Since EZ is a free market area with fixed exchange rate and it can't be considered as an *optimal* currency area<sup>58</sup>, austerity become competitive due to employment gains through mercantilist policies are reached at the expense of employment losses in other countries<sup>59</sup>. Then, competitive austerity are a kind of *beggar-thy-neighbour*, due to the lack of fiscal and monetary sovereignty does not allow countries to implement proper demand policies.

Following these critical arguments, we consider questionable the *neoclassical* view of "temporary" and "good" imbalances suggested by [Blanchard & Giavazzi, 2002] since according to mainstream scholars they should be adjusted by competitive austerity - which would contain aggregate demand<sup>60</sup>. However, the neoclassical view seems to be endorsed even by EZ policy makers, which imposed austerity combined with structural reforms: these latter often heighten inequalities and they are deeply redesigning, *in a regressive sense* [Stirati, 2012], income distribution and welfare. Especially, privatisations would benefit a small rich elite, with no advantages for wider population in case privatised companies play an important

---

<sup>57</sup> Germany CA balance (% of GDP): 1999, -1.35; 2000, -1.83; 2007, +7.48; 2012, +7.10 (Source: OECD).

<sup>58</sup> According to Mundell [1968], "an essential ingredient of a common currency area is a high degree of factor mobility". We claim that within EZ labour market is not totally integrated in terms of laws, languages and cultures; by contrast, capital market is fully integrated, and its integration benefited also to the absence of exchange rate risk.

<sup>59</sup> To this regard, we can quote Keynes [1936] argument: "...if nations can learn to provide themselves with full employment by their domestic policy (...), there need be no important economic forces calculated to set the interest of one country against that of its neighbours. There would still be room for the international division of labour and for international lending in appropriate conditions. But there would no longer be a pressing motive why one country need force its wares on another or repulse the offerings of its neighbour, not because this was necessary to enable it to pay for what it wished to purchase, but with the express object of upsetting the equilibrium of payments so as to develop a balance of trade in its own favour. International trade would cease to be what it is, namely, a desperate expedient to maintain employment at home by forcing sales on foreign markets and restricting purchases, which, if successful, will merely shift the problem of unemployment to the neighbour which is worsted in the struggle".

<sup>60</sup> In this view, we note that EZ policy makers regard wages only as cost factor rather than a source demand. By contrast, according to Stockhammer [2011] an increase in wage share would have expansionary effects.

social welfare function<sup>61</sup>; furthermore, austerity leads to higher unemployment and lower economic growth, while governments - forced to fiscal constraints - shall cut welfare programs which benefit the weakest members of society. In addition to this, in deficit countries austerity inhibits public investments, which should be able to innovate production system, improving long-run efficiency and competitiveness - hence, able to get better trade imbalances. Moreover, deficit countries are experiencing a huge slowdown of economic activities which lead national firms to international processes of merger and acquisition<sup>62</sup>, or even to become international sub-suppliers. Finally, wage deflation in countries which exhibit an high level of debt could be problematic: especially, lowering tax revenue due to lower income may increase debt-ratios, while decreasing nominal wages should seriously affect private system since households could not repay their private debt to banks.

For all these reasons, in this essay we claim that a painful process of internal devaluation by means of wage deflation would be dangerous and counterproductive in terms of growth, as it would be related to lowering aggregate demand - especially consumption - in deficit countries. To this regard, ILO [2012b] recently argued that any recovery strategy should be “*wage-led*”, especially in light of wage share is constantly decreasing in the EZ in last decades. Supply-side policies based on labour market deregulation are actually able to reduce real wages during slowdowns, and this view seems to be shared even by policy makers: in fact, IMF [2016] argued that “*reforms to employment protection arrangements and unemployment benefit systems have positive effects in good times, but can become contractionary in periods of slack*”. Consequently, the *competitive austerity* approach is not the right tool to solve EZ issues (growth and unemployment), while it has been considered proper for external imbalances realignment. To sum up, competitive austerity means forcing workers to bear the brunt of the adjustment: any temporary advantage one country gets by forcing down wages will be eliminated as soon as its competitors make the same choice. In other words, due to no trade restrictions austerity become competitive since employment gains in one country will come at the expense of employment losses abroad<sup>63</sup>. Then, we argue that *competitive austerity* is a kind of *beggar-thy-neighbour* with a different name: as long as deficit countries cannot run independent fiscal and monetary policies they will not address the root cause of unemployment, since this is the consequence of restrictive fiscal measures taken abroad.

### 6.3 - Internal devaluation and currency depreciation

Competitive austerity is then able to reduce aggregate demand not only through fiscal restraints, but from a Keynesian perspective also negatively affecting consumption and investment. In this scenario, the

---

<sup>61</sup> According to this argument, Busch & al. [2013] argued that “*the EU’s anti-crisis policies are accompanied - especially in Southern Europe - by harsh austerity policies, bringing in their wake growing unemployment, falling real wages, cuts in the social security system and privatization of public property*”.

<sup>62</sup> Krugman [2000] identified these international operations as “*Fire-Sale FDI*”.

<sup>63</sup> “*...if nations can learn to provide themselves with full employment by their domestic policy (...), there need be no important economic forces calculated to set the interest of one country against that of its neighbours. There would still be room for the international division of labour and for international lending in appropriate conditions. But there would no longer be a pressing motive why one country need force its wares on another or repulse the offerings of its neighbour, not because this was necessary to enable it to pay for what it wished to purchase, but with the express object of upsetting the equilibrium of payments so as to develop a balance of trade in its own favour. International trade would cease to be what it is, namely, a desperate expedient to maintain employment at home by forcing sales on foreign markets and restricting purchases, which, if successful, will merely shift the problem of unemployment to the neighbour which is worsted in the struggle.*” [Keynes, 1936].

only component of aggregate demand that may increase is the external one, likely due to decreasing prices. However, exchange rate regime is quite crucial: in case of fixed exchange rate (e.g. within EMU) falling prices can allow for trade balance improvements, even if in case of a high integrated area as EMU this would mean that other countries would lose market shares. This would be considered as a *beggary-neighbour* strategy in case institutional framework does not provide, as in the case of EZ, for a shared adjustment mechanism (i.e. fiscal transfers from surplus to deficit countries). By contrast, within EZ external adjustment is to be considered as “*compulsory for the debtor and voluntary for the creditor*” [Keynes, 1980]: while core countries should increase their demand in order to reduce external surplus<sup>64</sup>, deficit countries can only restore their competitiveness by means of internal devaluation.

Contrariwise, in a flexible exchange rate system persistent external deficit would lead to a currency depreciation: this mechanism would likely allow for an adjustment of relative prices and, in case of an economy which exhibit a sufficiently advanced production system, would foster export as well as engender import substitution processes. This combined effect would stimulate income and employment<sup>65</sup>. Anyhow, within EZ this mechanism is not feasible and competitiveness has to be recovered by means of internal deflation, hence by reducing labour costs<sup>66</sup>. In contrast with Blanchard [2006], we argue that a wage deflation adjustment is quite different from a currency depreciation: only in case prices of non-traded goods were perfectly flexible, as well as all prices immediately adjusted to wage reduction, the price competitiveness effect would be similar<sup>67</sup>. However, this appears quite unrealistic since prices are usually sticky: to this regard, Artus [2011] claimed that a generalized wage reduction can lead to a “*far more pronounced loss of purchasing power than an exchange-rate depreciation*”. Then, there is no assurance that austerity measures would improve competitiveness through wage reductions since the “profitability effect” can confine the competitiveness one.

#### 6.4 - Output, domestic demand and unemployment

If austerity policies since 2009 have been reducing external imbalances within EZ, they are negatively affecting deficit countries real growth (see Graph 13) and unemployment (see Graph 14), already harmed by 2007 financial crisis. Macroeconomic evidence is itself sufficient to refute the expansionary austerity view, then we claim that policy makers shifted their focus on external competitiveness issue to prosecute restrictive policies. In our opinion, since its foundation Eurozone has been facing a signal lack of domestic demand, and this question is not solvable through export policies nor wage competitiveness for

---

<sup>64</sup> This seems not to be the case of Eurozone, where surplus countries are financing external deficits of periphery through international capital flows. However, this not implies external adjustment, since core countries would keep their surplus. To this regard, it can be argued that in the long run external debt could be unsustainable even within a monetary union for three reasons: 1) in case peripheral countries would finance external deficits by means of international loans, they could face a debt crisis; 2) in case imbalances would persist, deficit countries would suffer the burden of adjustment in terms of unemployment and worsening welfare; 3) increasing deficits would be related to huge capital outflows, hence deficit countries could be motivated to leave the monetary union.

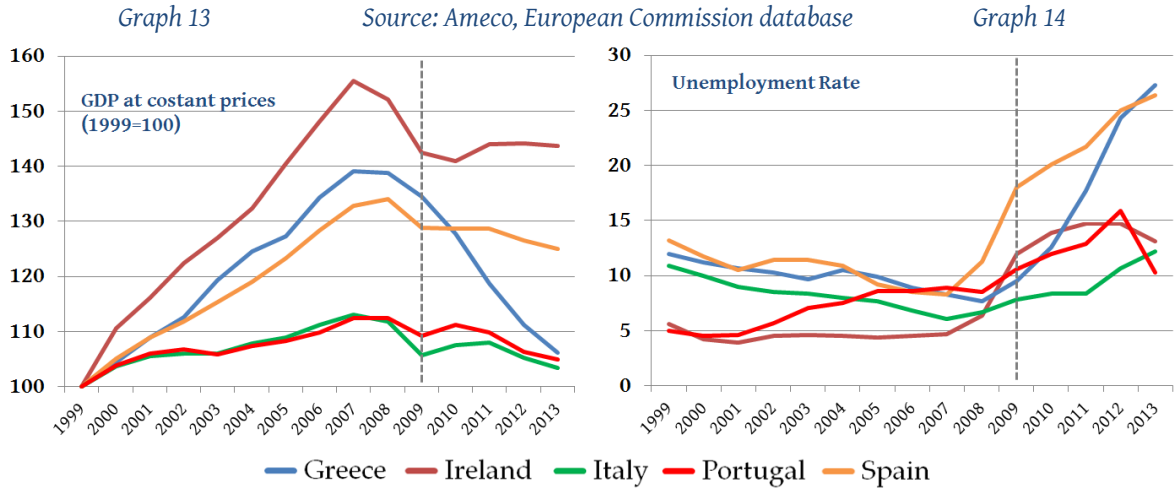
<sup>65</sup> Nevertheless, there is no assurance that increasing relative prices of import would improve trade balance: to this regard, *Marshall-Lerner* condition should be verified. Formally, this indicates that a currency devaluation would have a positive impact on trade balance only in case the sum of import and export price elasticities (in absolute terms) is greater than one.

<sup>66</sup> In this respect, *mainstream* arguments have been advanced by Dadush & Stancil [2011], which claimed that peripheral countries workers are too expensive compared to their more efficient German competitors: this appears consistent with the argument that deficit countries could restore their external competitiveness only through real wage adjustment.

<sup>67</sup> We remind that wage deflation would result quite different from currency devaluation with respect to the debt burden: falling wages would make credit market more nervous, especially in case loans are intermediated by the banking system.



two reasons: firstly, because great portion of EZ trade continues to be carried out internally; secondly, since wage restraint policies and fiscal austerity negatively affect internal demand. According to our view, austerity main consequence would be a contraction of the continental economy as a whole.

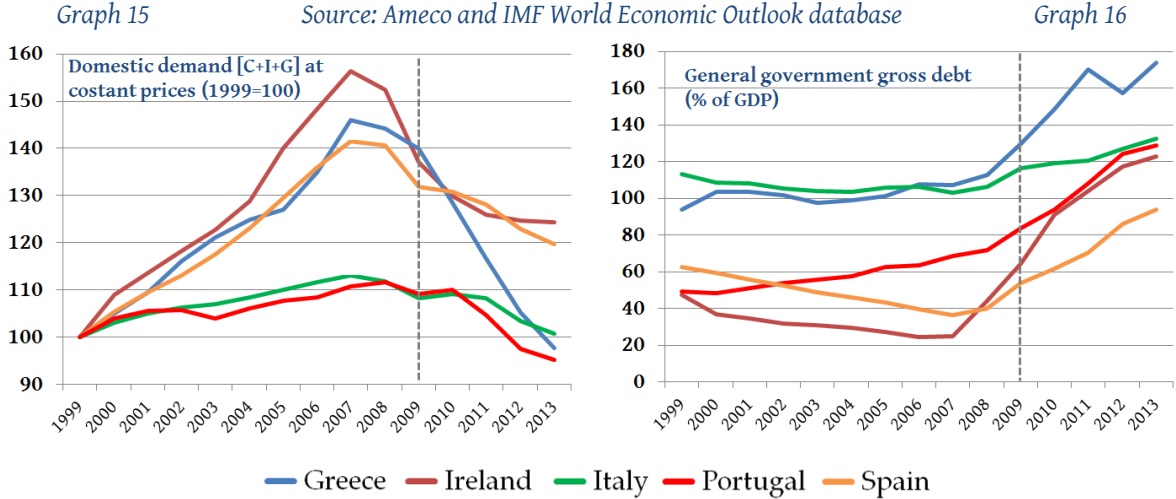


In addition, these policies (both wage reductions and fiscal austerity) could actually lead to deflation: if core countries<sup>68</sup> inflation systematically settles below 2%, in peripheral countries price competitiveness gains are feasible only with close to zero or negative inflation rate, with both redistributive and default risks of deflation. Summing up, we argue that EZ troubles rely on core countries economy (above all on Germany), where external demand is more central than internal demand: according to data, German growth is mainly determined by price-competitiveness, but this model can't be generalized to all EZ countries. While actual restrictive measures suggest deficit countries to pursue an export-led recovery, in a Keynesian perspective both monetary and fiscal expansionary policies are able to sustain growth and employment: within this approach, the spectre of inflation (which would erode price competitiveness) is not the automatic result of expansionary policy, while it depends on other factors (e.g. the distribution conflict, which becomes more fervent when the economy approaches full employment). Actually, we consider inflationary pressures as unlikely because of high unemployment and under-utilised output capacity. However, policy makers are attempting to improve competitiveness through lower inflation could need several years, and they could involve high costs in terms of growth and unemployment. As a matter of fact, austerity pushed peripheral countries into recession: GIIPS total outputs are still significantly below pre-crisis levels, hence unemployment rate is very high.

Moreover, it could be argued that in a long recession output capacity does not just remain idle, while it could be actually destroyed (especially not utilized capacity). Human capital could be destroyed too, as redundant workers are dispersed and their skills will become obsolete, while net investment could fall below zero as unutilized capital would not be replaced. To this regard, [Vianello \[2005\]](#) argued that *an insufficient demand protracted over time unavoidably generates a slowdown in the formation of new productive capacity and therefore of potential income*. As a matter of fact, until 2008 both GDP and potential GDP was growing, while in the following periods collapsing demand led GDP down: although until 2012 potential

<sup>68</sup> For instance, Germany CPI growth rate: 2010, 1.12; 2011, 2.31; 2012, 1.98 (Source: Ameco).

GDP did not decline, actual lack of demand is destroying output capacity<sup>69</sup>. Moreover, trend in aggregate demand is still able to cause a lower growth rate of output capacity, not only to destroy it. Then, austerity is able to depress real economy (by depressing aggregate demand) even in the long-term, while its declared aim is to deflate economy in the short-run in order to improve external competitiveness.



6.4 - A failed fiscal consolidation

While actual restrictive policies can be considered as a deliberate deflation of domestic wages and prices through cuts on public spending - designed to reduce both government and external deficits - austerity has not led to fiscal consolidation (intended as lower debt-to-GDP ratios). One purpose of these policies was to restore investors confidence by overwhelming sovereign debt spreads, and in so doing reducing public debt unsustainability fears. However, from an alternative standpoint we consider fiscal discipline as a weak measure to mitigate yield differentials, as well as an inadequate tool for solving EZ crisis since its architecture does not involve proper adjustment instruments (e.g. a common fiscal policy). For these reasons, we argue that the main cause of spread mitigation was ECB intervention in the secondary markets - by means of Securities Markets Programme (SMP) and proper institutional mechanisms (e.g. ESM) - to sustain sovereign bonds demand. In doing this, ECB makes however its intervention as conditional to austerity policies. According to data, since 2009 (i.e. when austerity measures started in peripheral countries) debt-to-GDP ratios have been rising steeply (see Graph 16): hence, fiscal restrictions have not achieved one of the expected results. On the contrary, austerity plans aimed to restore investors confidence (i.e. to lower bonds yield, thus facilitating debt refinancing) led to higher debt-to-GDP ratios. In this framework, rising risk premiums (and consequently higher bond yields) should be a consistent effect. Nevertheless, credit spreads are actually lower than in 2010/2011, as a result of ECB policies aimed to prevent further spreads widening rather than as a result of austerity plans. On these basis, we can assert that ECB interventions were powerful enough to control sovereign

<sup>69</sup> In the case of Italy, IMF estimates of potential GDP damage are ranged between 7% and 12%. In this framework, we argue if decreasing potential GDP had been caused by austerity policies, a kind of paradox would be realized: a decrease in potential growth (caused by restrictive fiscal policies) would cause an increase in deficit-to-GDP ratio - since this ratio is calculated on potential GDP- and this in turn should lead to further austerity measures.

bonds' yields [Levrero, 2014], with a scarce or nil influence for fiscal policy - apart from the fact that ECB measures were conditional to austerity policies.

Still following Keynesian arguments, the fact that restrictive fiscal policies led to growing debt-to-GDP ratios might be related to the role and the magnitude of fiscal multipliers: for instance, a government budget surplus might reduce the denominator (total income), and debt-to-GDP ratio might increase despite the reduction in public debt<sup>70</sup>. *Conventional* wisdom (i.e. austerity is the only way to make debt sustainable) can be than criticised by arguing that an increase in government spending (in case the economy was below full employment) may reduce debt-to-GDP ratio [Ciccone, 2002; Leão, 2013] due to the fiscal multiplier effect. In this framework, also IMF research papers revised upwards estimates of fiscal multipliers [Blanchard & Leigh, 2013], that were previously assumed to be on average (1970-2009) about 0,5 for advanced countries. In brief, fiscal consolidation is more expensive in terms of output loss than previously believed: the higher are fiscal multipliers, the higher is the probability that fiscal consolidation will have a *perverse* effect [Nuti, 2013] (i.e. it will increase debt-to-GDP ratio), especially since fiscal multipliers are likely to be higher in a downturn than during expansions.

As a matter of fact, since Euro inception GIIPS countries have been experiencing different fiscal policies. Spain and Ireland ran primary public surpluses until 2008, then bailouts and automatic stabilizers - due to 2007 financial crisis - led to fiscal deficits. Italy is the most striking case, as primary fiscal deficits were experienced only in 2009 and 2010. However, Portugal and Greece have been recording primary deficits respectively since 1999 and 2003. Besides, this picture changes dramatically if we consider net public lending/borrowing instead of primary, i.e. if we include debt services<sup>71</sup> in government expenditure: only Ireland net public balance is consistent with primary public balance, while in all other cases we observe net public deficits due to interests expenditure. According to data, the most alarming issue is that debt service has represented (on average 1999/2012) almost 5% of GDP for Italy and Greece, while for Spain, Portugal and Ireland interest expenditure settled between 2% and 3% of GDP. For some countries, it means lowering debt service would have a greater effect than a painful fiscal consolidation. However, also in absolute terms public debts are increasing (except for Greece in 2012, due to debt haircut), highlighting that fiscal consolidation can be considered as largely failed.

#### 6.5 - Does non-price competitiveness matter?

According to other scholars, *competitive austerity* was not able to affect trade balances (via wages and prices reduction) since price competitiveness is not the main driver of Eurozone CA misalignments. In this regard, the idea that Germany external surplus depended on price competitiveness was criticised by Danninger & Joutz [2007], which focus on both productive structure and trade composition: they argue that a *vis-à-vis* comparison with Germany could be misplaced for some countries, since Germany export basket is quite different from peripheral countries one. According to this argument, *competitive austerity* is considered as a wrong recipe for EZ imbalances since it would further damage the industrial system of

---

<sup>70</sup> A decreasing stock of public debt can actually be experienced only in case interest expenditure is greater than primary surplus; otherwise, debt stock will increase despite restrictive fiscal policies.

<sup>71</sup> The breakneck growth of spreads (occurred before ECB intervention) dramatically increased interest expenditure. To this regard, Barba & Pivetti [2009] argued that public debt, instead of private, can be "*checked by interest rate control*".

deficit countries, while lower wages would not restore external competitiveness because of the complexity of Northern countries export. Besides, deficit countries need to improve their production bases in order to compete with Germany on a greater number of goods. According to this argument, as well as wage moderation in “core” sectors (i.e. export oriented industries) and off-shoring, Germany implemented proper industrial policies based on diversification and specialization in order to get a competitive edge in several sectors, achieving the so called “complete production matrix”. By contrast, peripheral countries specializations are actually recorded in few industrial areas, hence lower prices in deficit countries may be ineffective to increase their competitiveness owing to a quite different export composition. Put it simply, competitiveness in terms of price could not be considered as a key factor for trade when the same good (understood as a good that meet the same consumer need) produced in different countries might differ in terms of quality and technological complexity.

According to this view, some scholars argued that even in case of strong surplus countries demand external imbalances would not decrease, while a generalized trade flows rebalance within EZ is required. To this regard, *Simonazzi & al. [2013]* stated that “*the present unbalanced pattern of trade (...) needs to be replaced with a truly multilateral network of trade flows; differences in price competitiveness (...) are only part of the explanation of the disequilibria, with a much greater role being played by the composition (and direction) of exports and the underlying organisation of production: it is the quality of exports that needs to be improved*”. Even within this approach fiscal restraints are not considered as a solution, since austerity would damage peripheral countries productive base, which is considered “*too narrow in quantitative and qualitative terms, to respond effectively to external demand*”. By contrast, industrial policies of import substitution, product up-grading and export matrix expansion would be useful to restore peripheral countries trade balance via no price-competitiveness (i.e. product competitiveness). The relevance of no-price competitiveness has been recently suggested also by policy makers<sup>72</sup>, although policy implications are quite different.

#### 6.6 - Current account: not only trade balance

Finally, since in the actual debate a country is roughly defined as competitive when it shows a CA surplus<sup>73</sup>, we claim that a narrow link between competitiveness and current account balance should be considered as misleading since CA includes - apart from real trade ( $X - M = TB$ , i.e. export less import of goods and services) - also net factor incomes from abroad (NY) and net cash transfers (NCT): especially, national accounts distinguish GDP and GNI with respect to current account, where  $CA = TB + NY + NCT$ . As a matter of fact, within Eurozone NCT<sup>74</sup> contribution to CA is negligible, while it is not possible to

---

<sup>72</sup> “(T)he revealed comparative advantage of EU manufacturing is linked to complex and high-quality product segments; by gradually increasing the complexity of their products, EU manufacturing industries managed to maintain their competitive position in 2009 compared with 1995” [*European Commission, 2013*]. Still, the previous release [*European Commission, 2012*] quoted: “Off-shoring seems to be mainly cost-driven; upstream quality gains may provide a viable alternative to cost-driven relocation”. *European Commission [2010]* also refers to no-price competitiveness: “price competitiveness has been the key factor explaining differences in export performance across Member States. Furthermore, non-price factors have also played a role and were especially important during current crisis”. Although European Commission shows a negative correlation between REER dynamics and market shares, the same report indicates that price competitiveness explains only 36% of market shares variability, hence no-price competitiveness is considered to be “another source influencing market share developments, including product differentiation, technological content and product quality”.

<sup>73</sup> Within the *Scoreboard of EU Macroeconomic Imbalance Procedure* we can see that the so called “alert mechanism” is activated in case of “3 year backward moving average of the current account balance as percent of GDP, with thresholds of +6% and -4%”.

<sup>74</sup> Current transfers take place when a certain foreign country simply provides currency to another country with nothing received as a return. Usually, these transfers are done in the form of donations, aids, or official assistance.

assert the same with respect to net incomes. Especially, national accounts consider NY as net factor incomes (both labour and capital) from abroad, thus a negative value means a country is paying to external factors more than its factors (employed in other countries) are receiving from abroad. As we showed in previous sections, within Euro area - also owing to no exchange risks - trade deficit are often financed by international loans (briefly, surplus countries are financing deficit countries), and this leads to negative net factor incomes in countries experiencing high external liabilities. In this framework, a debt spiral can be a consistent consequence<sup>75</sup>. Besides, further considerations can be advanced detecting surplus countries CA composition. To this regard, we provide Germany (considered as an international creditor) balance on CA vis-à-vis Euro area member states (see Table 4) in order to better identify relationships within EMU. First of all, we immediately observe Germany CA vis-à-vis EMU members became positive in 2000 (after more than a decade of negative), and it largely depended on increasing trade balance - doubled if compared to 1999 - which experienced a steady growth up to 2008. Besides, net incomes share on CA was negative up to 2006, when it became positive (19,7%). Since 2006, this data has been persistently increasing, and it surpassed trade balance share in 2013. As NCTs contribution to CA is quite constant, it means that Germany CA is experiencing a shift from trade balance to factor incomes earned from abroad. According to these data, we claim that the use of CA as a proxy for external competitiveness is highly misleading since they consider also net incomes, not only real trade. To this regard, since surplus countries are international creditor within EMU, NY are often capital incomes.

*Table 4 - Germany CAB (billion) vis-à-vis Euro-area - Source: Bundesbank (author's elaboration)*

Year	CA	TB	Y +	Y -	NY	NCT	TB/CA	NY/CA	NCT/CA
1992	-122,98	1585,51	23683,37	22232,65	1450,72	-3159,21	-	-	-
1993	-4062,30	-769,35	24724,31	25306,38	-582,07	-2710,88	-	-	-
1994	-6329,27	-649,92	23841,93	26525,89	-2683,96	-2995,39	-	-	-
1995	-12336,02	-1648,43	21710,40	29643,27	-7932,87	-2754,72	-	-	-
1996	-8447,12	546,16	25084,69	31336,48	-6251,79	-2741,49	-	-	-
1997	-10336,60	-1667,31	29462,93	35210,83	-5747,90	-2921,39	-	-	-
1998	-4735,29	4216,36	32926,20	38900,82	-5974,62	-2977,03	-	-	-
1999	-1747,50	7696,08	40845,36	47644,99	-6799,63	-2643,95	-	-	-
2000	12155,84	14359,03	56331,62	55250,20	1081,42	-3284,61	118,1%	8,9%	-27,0%
2001	7505,01	22543,81	51328,49	62830,08	-11501,59	-3537,21	300,4%	-153,3%	-47,1%
2002	13165,29	33656,62	51581,15	68629,61	-17048,46	-3442,87	255,6%	-129,5%	-26,2%
2003	15949,86	38388,42	51791,89	70583,99	-18792,10	-3646,46	240,7%	-117,8%	-22,9%
2004	49350,42	56143,30	67308,99	70115,10	-2806,11	-3986,77	113,8%	-5,7%	-8,1%
2005	62423,70	69511,06	73801,39	77166,86	-3365,47	-3721,89	111,4%	-5,4%	-6,0%
2006	85944,60	72397,30	96674,61	79774,77	16899,84	-3352,54	84,2%	19,7%	-3,9%
2007	108973,28	95118,55	121875,94	103007,12	18868,82	-5014,09	87,3%	17,3%	-4,6%
2008	96816,52	84323,34	104769,37	88356,40	16412,97	-3919,79	87,1%	17,0%	-4,0%
2009	96376,27	63744,04	101839,21	64488,99	37350,22	-4717,99	66,1%	38,8%	-4,9%
2010	75534,22	64246,33	99786,81	82434,62	17352,19	-6064,30	85,1%	23,0%	-8,0%
2011	87120,39	59394,48	114269,05	81940,59	32328,46	-4602,55	68,2%	37,1%	-5,3%
2012	73571,06	43062,14	110381,91	75027,57	35354,34	-4845,42	58,5%	48,1%	-6,6%
2013	57404,71	28971,07	104804,64	72745,94	32058,70	-3625,06	50,5%	55,8%	-6,3%

<sup>75</sup> Debt spirals can be actually verified in the EZ framework. For instance, Spain net incomes were -7.7 billion in 1998, -17.1 in 2005 and -35.5 in 2008; Greece net incomes were -1.4 billion in 1998, -5.6 in 2005 and -10.6 in 2008; Ireland net incomes were -9,4 billion in 1998, -24.9 in 2005 and -25.2 in 2008 (Source: Eurostat). According to data, a large share of CA worsening (which negatively affects net foreign assets) can be explained by negative net incomes, especially for Ireland.

## 7. Final remarks

The main goal of this essay was to crucially examine the linkage between austerity and competitiveness - suggested by policy makers - which lies in the restrictive measures implemented in Eurozone periphery to face the external imbalances issue. To this purpose, we advanced a critical discussion of the debate about EZ crisis - intended as the widening of sovereign debt spreads - as well as about actual policies: especially, the crucial point of this essay (both from a theoretical and an empirical standpoint) was the role of austerity agenda as a tool for fostering deficit countries competitiveness.

In light of this critical essay, we argue that (alleged) fiscal indiscipline of peripheral countries does not seem to be the root cause of EZ crisis. Indeed, single currency inception has boosted CA imbalances, leading to the creation of two structurally different areas within the EMU (North and periphery): EMU led to greater market openness, along with a stricter leeway to macroeconomic tools (e.g. expansionary fiscal policy and currency devaluation). When in 2010 sovereign debt crisis broke out, Eurozone policy makers decided to tackle it imposing fiscal austerity to peripheral countries. However, we claim that credit spreads have been lowered as a result of ECB operations, while such support was conditional on governments' austerity programmes. Although restrictive fiscal policies actually worsened debt-to-GDP ratios, they are still in progress even if their focus has been switched over trade imbalances, and consequently on the controversial "competitiveness issue": we advance some arguments according to which Eurozone policy makers may have moved from *expansionary austerity* to *competitive austerity*.

However, the actual EZ status is quite puzzling, due to the fact that whole area current account is almost on balance, while divergences between member states have increased since the monetary union. So far, neither economic literature nor empirical evidence traced a single cause for external imbalances. In this paper, we classify CAs determinants in *supply-* and *demand-side* factors. The first ones refer to the fact that Northern countries benefited from low ULC growth (due to weak wage dynamics rather than productivity growth) and low inflation rates; hence, they exploited a real exchange rate depreciation. Endorsing this approach, external imbalances are driven by price differentials, hence policy makers required to restore deficit countries competitiveness by reducing production costs. The second ones are related to different growth models resulted from EMU: on the one hand, Northern countries pursued restrictive wage and fiscal policies in order to achieve export-led growth; on the other hand, peripheral countries experienced both increasing domestic demand and real income growth, fuelled by increasing private debt due to the cheaper access to financial markets. All of this outlined remarkable divergences across countries: especially, in credit-led countries agents financed consumption and housing investments through debt, providing for a great source of demand to export-led countries. The mutual action of these motions led to the actual situation of both real and financial intra-EZ imbalances.

Even though Eurozone policy makers recognise demand factors as a relevant cause of CA imbalances, official reports continuously focus on the competitiveness channel, then an asymmetric adjustment shall burden the periphery via deflation - hence, *competitive austerity* would be in a sense justified. In addition to this, some Northern countries - especially Germany - show remarkable internal imbalances (reflecting a topical growth model, based on export support and consumption restraints) which affect both

aggregate demand and income trend/composition. Although Germany has been experiencing low growth rates since Euro inception, we show that Germany GDP dynamics mainly depend on net export, which explain more than 40% of real growth. According to data, we argue weak domestic demand played a key role in increasing its CA surplus within EZ.

Obviously, the existence of opposite growth models is unsustainable as indebtedness can't expand without any limit, while both wage restraints and fiscal austerity in the periphery will be useless to solve this problem: *competitive austerity* would just correct imbalances, but it will negatively affect aggregate demand, prejudicing Southern countries' ability to settle debts. Nevertheless, *Troika* affirms austerity would enable a long-run recovery inasmuch it fosters trade performances. Based on this pure *mainstream* view, restrictive fiscal measures started in 2009 (as a counterpart to ECB interventions on sovereign bonds secondary market) in order to face the sudden rise of spreads. In addition to public debt sustainability, according to EZ policy makers austerity would restore competitiveness and reduce CA imbalances through *supply* channels (fostering export by reducing wages and then prices). According to data, *demand* channels (containing output, then reducing the endogenous component of import) have been prominent in determining trade balance adjustment. In parallel with fiscal austerity, Southern countries were forced to implement *structural reforms* aimed at increasing external competitiveness through internal devaluation. In this essay we claimed that these channels operate consistently with our twofold explanation of imbalances: from a *supply-side* standpoint these measures are aimed to restore price competitiveness (fostering export), while from a *demand-side* standpoint austerity will reduce income growth (containing import). In a nutshell, policy measures in deficit countries have been approved on the basis of *competitive austerity*, based on export-oriented productions, labour market deregulation, low inflation, decreasing real wages, cuts in public expenditure, privatisation measures, interventions on welfare system, reduction of public employees' cost and local governments' unifications.

In light of arguments provided in this essay, we consider austerity's theoretical basis as misleading since they contradict usual Keynesian arguments: higher taxes (or decreasing government expenditure) may have contractionary effects - amplified by fiscal multiplier - on aggregate demand, then in total output. Moreover, decreasing prices and wages can increase the burden of debt, inducing agents to hold money rather than consume. Moreover, owing to falling aggregate demand also private investments are supposed to decrease: to this regard, we consider crowding-out as a controversial thesis. As for deflation, there is no assurance that a fall in wages will lead to an equivalent fall in prices: if decrease in prices is lower than decrease in wages, price competitiveness effect will be quite poor. In addition to this, according to *functional distribution* of income, such switch in favour of profits (at the expense of wages) could lead to further decreases in output due to decreasing aggregate demand. As well as unemployment and economic recession, austerity policies often amplify inequalities, since governments are cutting welfare spending programs which benefit the weakest members of society. Moreover, fiscal restraints in deficit countries can hinder public investments, which are able to innovate production systems and to improve productivity and competitiveness. Finally, so long as all countries continue to pursue export-led strategies (as suggested by EU policy makers), austerity will continue to get worse wage earners' living

standards: *competitive austerity* is leading ever greater labour market flexibility, aimed to press down wages in order to compete in a more global economy and to preserve (or to increase) market shares.

In this essay we consider actual austerity policies as consistent with a competitive deflation adjustment based on liberal arguments: *competitive austerity* measures concerned mainly deficit countries growth restraint in order to curb imports, and deflation in order to foster export. From a Keynesian standpoint, we assert these measures are also contracting internal demand, with a dramatic impact on industrial structure, employment and welfare: wage deflation could be counterproductive inasmuch it will lead to a contraction of deficit countries internal demand. Actually, austerity is dramatically affecting real GDP dynamics and unemployment trends, due to the fact that a great portion of European trade is carried out internally and it is not possible to generalise an export-led growth model. We argue these policies can also lead to deflation, since core countries inflation remains very low. By contrast, we consider both monetary and fiscal expansionary policies as able to sustain growth and employment: actually, inflationary pressures appear unlikely due to high unemployment and to under-utilised capacity. In fact, austerity contributed to push periphery into recession (Southern countries GDPs are still below pre-crisis levels, while unemployment rate are dramatically high): despite a declared aim of fiscal restrictions is to deflate real economy in the short-run, austerity is able to depress real economy even in the long-term. Finally, competitiveness increases through austerity would negatively affect productivity, since deflation would reduce actual investments: this scenario will be inconsistent with policy guidelines, which aim to foster productivity - through productive investments - in order to foster competitiveness.

In addition to this, data show that austerity didn't lead to peripheral countries fiscal consolidation: while restrictive policies were aimed at restore investors confidence by overwhelming sovereign debt spreads and by reducing public debt unsustainability fears, since 2009 debt-to-GDP ratios have been rising steeply. Although fiscal restrictions have not achieved one of the expected results, credit spreads are actually lower than in 2010 - as a result of ECB rescues on bonds secondary market rather than due to austerity. Following Keynesian arguments, we argue that debt-to-GDP ratios crucially depend on fiscal multipliers: in case of austerity, debt ratios might increase due to recession. In this regard, fiscal consolidation has been more expensive in terms of output loss than believed (also IMF recently revised upwards fiscal multipliers estimations): the higher is fiscal multiplier, the higher is the probability that fiscal consolidation will have negative effect. This argument appear valid since fiscal multipliers are likely to be state-dependent, i.e. higher during slumps than in economic booms.

Moreover, we argue that a strict focus on CAs should be considered as misleading also due to the fact that CAs include - apart from real trade - also net factor incomes from abroad. Since trade deficits are often financed by international loans (surplus countries are financing deficit countries), this is leading to negative net factor incomes in countries experiencing high external liabilities. According to data, net incomes contribution to surplus countries CAs is very high (actually, 55% for Germany *vis-à-vis* EZ), hence a debt spiral could be a consistent consequence. Briefly, the use of CA as a proxy for competitiveness is highly misleading since it means not only real trade but also net incomes are considered: as surplus countries are international creditor within EMU, these flows are usually capital incomes.



To sum up, we argue Euro area needs different policies to sustain aggregate demand and to promote a balanced growth model. *Competitive austerity* is only transferring the burden of the adjustment to deficit countries: restrictive fiscal policies will not solve the root problems of the monetary union (namely, lack of domestic demand), but they are likely to worsen them. Moreover, unemployment is becoming dramatic in peripheral countries: *mainstream* arguments suggest only labour market deregulation, while unemployment issue can basically relies on low aggregate demand – then, austerity measures will be very counterproductive. Sovereign debt crisis seems to be the result of a broader macroeconomic crisis, and a strict focus on fiscal policy appears confined. Moreover, CA imbalances don't depend on the failure of fiscal rules, then further fiscal restrictions are not consistent with our arguments – due to the fact that austerity has a contractionary effect on aggregate demand, hence it is able to foster recession.

In this essay we provide a critical interpretation of Eurozone imbalances. According to our arguments, *competitive austerity* in deficit countries can't be considered as a proper solution. By contrast, we assert the burden of the adjustment should be shared with a significant contribution of surplus countries: briefly, policy makers should lead Northern countries to foster their domestic demands (and inflation), while peripheral countries should be allowed to carry on policies aimed at improve their productive structures. Therefore, we consider the austerity-competitiveness linkage as misleading owing to the fundamental causes of imbalances: EMU countries should not ground economic growth on exports - it will only lead to wage competition – and policies of labour costs restraint, labour market deregulation and cuts in government spending are not proper tools to foster competitiveness, especially if gains in price competitiveness are achieved through growing unemployment. In light of the foregoing, we suggest an alternative recipe to solve the EZ question based on Keynesian arguments: if the burden of adjustment was shared, competitiveness realignments would be suitable through higher inflation in surplus countries (even if ECB inflation target should be rectified), and also a coordinated wage policy should be pursued. Moreover, with low consumption and investments (which we consider largely endogenous), public expenditure appears the only eligible tool to sustain deficit countries aggregate demand and employment. In this framework, we clinch both inflation and crowding-out effects are unrealistic given spare output capacity and high unemployment.

For all these reasons we conclude that the connection between austerity and competitiveness is questionable since it is based on pure *mainstream* arguments. Endorsing the *competitive austerity* view, EU policy makers explain almost totally imbalances referring to weak deficit countries price competitiveness: in so doing, they neglect all demand factors. Consequently, fiscal austerity measures imposed on the periphery would have a direct impact on trade balances, but a depressive effects on real income and employment. By contrast, following Keynesian arguments in this paper we disproved the austerity-competitiveness linkage both from a theoretical and an empirical perspective, as well as we suggest an alternative recipe to EZ crisis.

## REFERENCES

- ALESINA, Alberto F.** (2010) - *Fiscal adjustments: lessons from recent history*, paper prepared for the ECOFIN meeting in Madrid, April 15.
- ALESINA, Alberto F., ARDAGNA, Silvia** (2009) - *Large changes in fiscal policy: taxes versus spending*, National Bureau of Economic Research, WP 15438, October.
- ALESINA, Alberto F., PEROTTI, Roberto** (1994) - *The Welfare State and Competitiveness*, National Bureau of Economic Research, WP No. 4810, July.
- ALESINA, Alberto F., PEROTTI, Roberto** (1995) - *Fiscal Expansions and Adjustments in OECD countries*, NBER Working Paper No. 5214, August.
- ALESINA, Alberto F., PEROTTI, Roberto** (2010) - *Germany spending is not the cure*, Voxeu.org, 17 June.
- ALESSANDRINI, Pietro, FRATIANNI Michele, HUGHES, Hallett, PRESBITERO, Andrea F.** (2012) - *External imbalances and financial fragility in the Eurozone*, MoFiR working paper No. 66.
- ARTUS, Patrick** (2011) - *Improving euro-zone countries' competitiveness: In what ways does a reduction in wages differ from a devaluation of the exchange rate?*, Natixis-Economic research, 14 September, No. 664.
- ATTINASI, Maria Grazia, CHECHERITA-WESTPHAL, Cristina D., NICKEL, Christiane** (2009) - *What Explains the Surge in Euro Area Sovereign Spreads During the Financial Crisis of 2007-09?*, ECB Working Paper No. 1131, December, 17.
- BAGNAI, Alberto** (2010) - *La morale della favola irlandese*, [archivio.lavoce.info](http://archivio.lavoce.info), 17 December.
- BAGNAI, Alberto** (2012a) - *Crisi finanziaria e governo dell'economia*, [costituzionalismo.it](http://costituzionalismo.it), Gennaio.
- BAGNAI, Alberto** (2012b) - *Il tramonto dell'Euro*, Imprimatur Editore, Novembre.
- BARBA, Aldo, PIVETTI, Massimo** (2009) - *Rising household debt: its causes and macroeconomic implications - a long-period analysis*, Cambridge Journal of Economics 2009, 33, 113-137.
- BAYOUMI, Tamim, HARMSSEN, Richard, TURUNEN, Jarkko** (2011) - *Euro Area Export Performance and Competitiveness*, IMF Working Paper No. 140.
- BELKE, Angsar, DREGER, Christian** (2011) - *Current Account Imbalances in the Euro Area: Catching Up or Competitiveness?*, Deutsches Institut für Wirtschaftsforschung Discussion Paper, Berlin 02-2011
- BENIGNO, Pierpaolo** (2012) - *La medicina Bce e il male europeo*, *Il Sole 24 ore*, 2 marzo 2012.
- BLANCHARD, Olivier** (2006) - *Adjustment within the euro. The difficult case of Portugal*, Portuguese Economic Journal, Volume 6 (2007), Issue 1 (April), Pages: 1-21.
- BLANCHARD, Olivier** (2007) - *Current Account Deficits in Rich Countries*, IMF Staff Papers 54(2):191-219.
- BLANCHARD, Olivier, GIAVAZZI, Francesco** (2002) - *Current Account Deficits in the Euro Area: The End of the Feldstein-Horioka Puzzle?*, Brookings Papers on Economic Activity, Economic Studies Program, The Brookings Institution, vol. 33(2), pages 147-210.
- BLANCHARD, Olivier, JOHNSON, David R.** (2013) - *Macroeconomics*, Sixth edition, Pearson.
- BLANCHARD, Olivier, LEIGH, Daniel** (2013) - *Growth Forecast Errors and Fiscal Multipliers*, IMF Working Paper No. 13/1, January.
- BLINDER, Alan S.** (1997) - *Is There a Core of Practical Macroeconomics That We Should all Believe?*, American Economic Review, 1997, n. 2.
- BRANCACCIO, Emiliano** (2008) - *Deficit commerciale, crisi di bilancio e politica deflazionista*, Studi Economici, n. 96-2008/3.
- BRANCACCIO, Emiliano** (2011) - *Crisi dell'unità europea e standard retributivo*, Diritti Lavori Mercati, II.
- BUSCH, Klaus, HERMANN, Christoph, HINRICHS, Karl, SCHULTEN, Thorsten** (2013) - "Euro Crisis, Austerity Policy and the European Social Model: How Crisis Policies in Southern Europe Threaten the EU's Social Dimension", *Friedrich Ebert Stiftung, International Policy Analysis, February*.

- CALMFORS, Lars** (1998) - *Macroeconomic policy, wage setting and employment: what difference does the EMU make?*, Institute for International economic studies, Stockholm University, Seminar Paper N.657.
- CESARATTO, Sergio** (2010) - *Alle origini della crisi europea in corso: spunti critici a margine di due rapporti della Commissione*, Dipartimento di Economia Politica, Università di degli studi di Siena, n.596.
- CESARATTO, Sergio** (2012) - *Controversial and novel features of the Eurozone crisis as a balance of payment crisis*, Dipartimento di Economia Politica, Università di degli studi di Siena, n.640.
- CESARATTO, Sergio** (2015) - *Alternative interpretation of a Stateless Currency Crisis*, Asimmetrie Working Paper, 2015/08.
- CESARATTO, Sergio, STIRATI, Antonella** (2011) - *Germany and the European and Global Crisis*, Dipartimento di Economia Politica, Università di degli studi di Siena, n.607.
- CHIRINKO, Robert S.** (1993) - *Business Fixed Investment Spending: Modeling Strategies, Empirical Results and Policy Implications*, Journal of Economic Literature, vol 31.
- CICCONE, Roberto** (2002) - *Debito Pubblico, Domanda Aggregata e Accumulazione*, Aracne, Roma.
- COMUNALE, Mariarosaria, HESSEL, Jeroen** (2013) - *Current account imbalances in the Euro area: competitiveness or financial cycle?*, DNB Working Paper n.433.
- DADUSH, Uri, STANCIL, Bennet** (2011) - *Is the euro rescue succeeding?*, VoxEU.org, 6 February.
- DANNINGER, Stephan, JOUTZ, Fred** (2007) - *What Explains Germany's Rebounding Export Market Share?*, IMF Working Paper n. 24.
- DE GRAUWE, Paul** (2011) - *The financial crisis and the future of the Eurozone*, Bruges European Economic Policy Briefings, n. 21, Bruges: College of Europe. Directorate-General for Economic and Financial Affairs, Economic Papers 498, April.
- DRAGHI, Mario** (2013) - *Euro area economic situation and the foundations for growth*, presentation by the President of the ECB at the Euro Summit, Brussels, 14 March 2013.
- EUROPEAN COMMISSION** (2009) - *Competitiveness developments within the euro area*, Volume 8, N.1.
- EUROPEAN COMMISSION** (2010) - *The impact of the global crisis on competitiveness and current account divergences in the Euro Area*, Volume 9, N.1.
- EUROPEAN COMMISSION** (2012) - *Scoreboard for the surveillance of macroeconomic imbalances*, European Economy Occasional Paper, No 92.
- EUROPEAN COMMISSION** (2013) - *European Competitiveness Report Executive Summary*.
- European Communities** (1990) - *One market, one money, an evaluation of the potential benefits and costs of forming an economic and monetary union*, Directorate general for Economic and Financial affairs, October.
- FRITSCH, Ulrich, ERBER, Georg** (2008) - *Labour productivity growth in good old Germany: is Germany falling further behind?*, www.ulrich-fritsche.net, 19 September.
- GABRISCH, Hubert, STAEHR, Karsten** (2012) - *The Euro Plus Pact: competitiveness and external capital flows in the EU countries*, Eesti Pank WP Series, 5/2012.
- GAREGNANI, Pierangelo** (1979) - *Valore e domanda effettiva, Keynes, la ripresa dell'economia classica e la critica ai marginalisti*, Torino, Einaudi.
- GAULIER, Guillaume, VICARD, Vincent** (2012) - *Current account imbalances in the Euro area: competitiveness or demand shock?*, Banque de France , Quarterly Selection of Articles, No. 27.
- GIAVAZZI, Francesco, PAGANO, Marco** (1990) - *Can Severe Fiscal Contractions Be Expansionary? Tales of Two Small European Countries*, NBER Macroeconomics Annual 5: 75-111. JSTOR 3585133.
- GIAVAZZI, Francesco, SPAVENTA, Luigi** (2010) - *Why the current account may matter in a monetary union, Lessons from the financial crisis in the Euro area*, Discussion Paper 8008, Centre for Economic Policy Research.
- GROS, Daniel** (2014) - *What makes Greece special?*, Project-Syndicate.org, Brussels, March 6.
- HALLET, Andrew Hughes, MARTINEZ OLIVA, Juan Carlos** (2013) - *The Importance of Trade and Capital Imbalances in the European Debt Crisis*, Peterson Institute for International Economics, WP 13-01.

- ILO** (2012a) - *Global Employment Trends, Preventing a deeper jobs crisis*, Geneva.
- ILO** (2012b) - *Global wage report 2012/13*, technical report.
- International Monetary Fund** (2010) - *World Economic Outlook, Rebalancing growth*, April, in *OECD Countries*, Discussion Paper Series No. 754, June.
- International Monetary Fund** (2016) - *World Economic Outlook, Too Slow for too Long*, April.
- J.P. MORGAN** (2013) - *The Euro area adjustment: about halfway there*, Europe Economic Research, 28/05/13.
- KALDOR, Nicholas** (1966) - *Marginal productivity and the macro-economic theories of distribution*, *Review of Economic Studies* 33(4), 309.
- KALDOR, Nicholas** (1971) - *The Dynamic Effects Of The Common Market*, firstly published in the *New Statesman*, 12 March 1971, and also reprinted in "Further Essays On Applied Economics" (Vol. VI, Chapter 12, pp 187-220).
- KALECKI, Michal** (1954) - *Theory of Economic Dynamics: An Essay on Cyclical and Long-Run Changes in Capitalist Economy*, 1965 reprint.
- KEYNES, John Maynard** (1936) - *The general theory of employment, interest and money*, Palgrave Macmillan, Cambridge University Press for Royal Economic Society.
- KEYNES, John Maynard** (1943) - *Proposals for an international clearing union*, British government publication, Cmd. 6437:20, London, April.
- KEYNES, John Maynard** (1980) - *The Collected Writings, Volume XXV: Activities, 1940-44 - Shaping the Post-war World: The Clearing Union*, Basingstoke.
- KRUGMAN, Paul** (1996) - *Pop internationalism*, The MIT Press.
- KRUGMAN, Paul** (2000) - *Fire-sale FDI*, in Edwards, Sebastian, "Capital flows and the emerging economies: theory, evidence, and controversies", NBER Books, Inc, December.
- KRUGMAN, Paul** (2014) - *Notes on Easy Money and Inequality*, The conscience of a liberal, Krugman Blog NY Times, October 25.
- LANE, Philip R., MILESI-FERRETTI, Gian Maria** (2007) - *The external wealth of nations mark II: Revised and extended estimates of foreign assets and liabilities, 1970-2004*, *Journal of International Economics* 73, November, 223-250, Updated and Extended "External Wealth of Nations" Dataset, 1970-2011.
- LEAO, Pedro** (2013) - *The Effect of Government Spending on the Debt-to-GDP Ratio: Some Keynesian Arithmetic*, *Metroeconomica*, Volume 64, Issue 3, pages 448-465, July.
- LESTRADE, Brigitte** (2010) - *Les réformes sociales Hartz IV à l'heure de la rigueur en Allemagne*, Notes du Cerfa, IFRI, June.
- LEVRERO, Enrico Sergio** (2012) - *Un passo indietro? L'euro e la crisi del debito*, in *Oltre l'austerità*, Micro Mega, Luglio.
- LEVRERO, Enrico Sergio** (2014) - *Potenza e limiti della BCE*, *Economia & Politica*, 6 maggio 2014.
- MARIN, Dalia** (2010) - *Germany's super competitiveness: a helping hand from Eastern Europe*, VoxEU.org.
- MAYER, Thomas** (2011) - *Euroland's hidden balance-of-payments crisis*, Deutsche Bank, EU Monitor n. 88.
- MERLER, Silvia, PISANI-FERRY, Jean** (2012) - *Sudden stops in the Euro area*, Bruegel policy contribution, issue 06, March.
- MUNDELL, Robert A.** (1968) - *A Theory of Optimum Currency Areas*, *International Economics*, New York, Macmillan, pp. 177-186.
- MURER, Philippe** (2012) - *Quels sont les véritables taux de chômage en France et en Allemagne?* Forumdemocratique.fr, 13 février 2012.
- NOCELLA, Gianluigi** (2015) - *Competitività e distribuzione funzionale nell'Eurozona*, a/working paper 2015/04 (March), asimmetrie.org.
- NUTI, Mario** (2013) - *Perverse Fiscal Consolidation*, Sbilanciamoci.info, 11 ottobre 2013.

- PAPADIMITRIOU, Dimitri B., NIKIFOROS, Michalis, ZEZZA, Gennaro** (2013a) - *Waiting for Export-led Growth: Why the Troika's Greek Strategy Is Failing*, Levy Economics Institute One-page-paper N.41, 05.09.
- PAPADIMITRIOU, Dimitri B., NIKIFOROS, Michalis, ZEZZA, Gennaro** (2013b) - *A Levy Institute model for Greece*, Technical Paper, May 2013.
- PEROTTI, Roberto** (2011) - *The "austerity myth": gain without pain?*, CEPR Discussion Paper, November.
- REINHART, Carmen M., ROGOFF, Kenneth S.** (2010) - *Growth in a time of Debt*, NBER Working paper series, Working Paper 15639, January.
- RICARDO, David** (1820) - *Funding system*, in *The works and correspondence of David Ricardo* (ed. critica a cura di P. Sraffa e M. Dobb), vol. IV, Cambridge 1951.
- SIMONAZZI, Annamaria, GINZBURG, Andrea, NOCELLA Gianluigi** (2013) - *Economic relations between Germany and southern Europe*, Cambridge Journal of Economics, 2013, 37, 653-675.
- SINN, Hans-Werner** (2012) - *The European balance-of-payment crisis*, CESifo Forum Volume 13.
- SINN, Hans-Werner** (2014) - *Austerity, Growth and Inflation: Remarks on the Eurozone's Unresolved Competitiveness Problem*, The World Economy, Vol. 37, Issue 1, pp. 1-13, January.
- STIRATI, Antonella** (2012) - *Crescita e riforma del mercato del lavoro*, in *Oltre l'austerità*, Micro Mega, Luglio.
- STOCKHAMMER, Engelbert** (2011) - *Peripheral Europe's Debt and German Wages. The Role of Wage Policy in the Euro Area*, Kingston University, Research on Money and Finance, Discussion Paper no. 29.
- STOCKHAMMER, Engelbert, ONARAN, Özlem** (2012) - *Rethinking wage policy in the face of the Euro crisis. Implications of the wage-led demand regime*, International Review of Applied Economics, Vol. 26, No. 2, March 2012, 191-203.
- THEODOROPOULOU, Sotiria, WATT, Andrew** (2011) - *Withdrawal Symptoms: an Assessment of the Austerity Packages in Europe*, European Trade Union Institute, Working Paper 2011.02.
- UXÓ, Jorge, JESÚS, Paúl, FEBRERO, Eladio** (2011) - *Current Account Imbalances in the Monetary Union and the Great Recession: Causes and Policies*, Panoeconomicus, 2011, 5, Special Issue, pp. 571-592.
- VIANELLO, Fernando** (2005) - *La Moneta Unica Europea*, Mimeo, in *Economia & Lavoro* (2013), XLVII-1, pp. 27-46.
- WHYTE, Philip** (2010) - *Why Germany is not a model for the Eurozone*, Centre for European Reforms.
- WOLF, Martin** (2011) - *What has the ECB done in the crisis? The role of TARGET balances*, Martin Wolf's Exchange, Economic Issues, December 28.
- WYPLOSZ, Charles** (2013) - *Europe's quest for fiscal discipline*, European Commission Economic Paper 498, April, ISSN 1725-3187.
- ZEZZA, Gennaro** (2012) - *La crisi dell'euro: invertire la rotta o abbandonare la nave?* in *Oltre l'austerità*, MicroMega, Roma.
- ZEZZA, Gennaro** (2013) - *Are structural reforms the Cure for Southern Europe?*, Multiplier Effect, The Levy Economics Institute Blog, September 30.
- ZEZZA, Gennaro** (2014) - *Export-led growth for Greece?*, Multiplier Effect, The Levy Economics Institute Blog, March 8, 2014.