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The Macroeconomic and Social imbalances in the Eurozone

in the period of Economic Crisis (2008 - 2014)

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Abstract

This paper attempts to shed light on the economic and social effects of the economic crisis among Member States of the Eurozone in the period 2008-2014 emphasizing the imperative revision of the framework of the Stability and Growth Pact. Particular emphasis is given to the growing Macroeconomic and Social imbalances between Euro (€) North and Euro (€) South, which had posed a threat to the economic viability and social cohesion in the Eurozone.

JEL Classification: D63, E02, E60, E62, H30

Key words: Eurozone crisis, Economic Inequality, Macroeconomic Imbalances, Social Imbalances, Stability and Growth Pact

1. Introduction

There is no denying that the Eurozone is experiencing an intense long-term transformation. One of the contributory factors in this process is the deepening economic crisis (2010 - 2014), which had posed a threat to the economic viability and social cohesion in the Eurozone, revealing several structural weaknesses in the initial Architecture of the Euro (€) and calling into question the progress that was achieved in previous years. The environment of "Secular Stagnation" (Summers, 2014, Teulings and Baldwin, 2014, Wren-Lewis, 2015, De Grauwe, 2015) and Macroeconomic and Social imbalances in the period 2008 - 2014, had reflected the inability to exit the economic crisis and shows that both the speed and intensity of institutional achievements in the common currency (which is characterized by increased heterogeneity between Member States), had failed to meet the speed and intensity requirements imposed by economic globalization and ongoing technological change. Consequently,

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certain weaknesses become evident when addressing the challenges which arise from economic, social, demographic and external (migration, terrorism etc.) factors, as the organization of internal institutions and the implementation of economic policy are being internationalized. In the context of the inverse correlation between Economic Effectiveness and Social Justice (Katz-Rosen, 1998, Varian, 2003, Krugman-Wells, 2012), it can be concluded that the structural reforms in the Welfare State and in the domains of Competitiveness, Labor Markets and Employment, had seriously affected endeavors to deepen the Eurozone and had led to dramatically increased conflicts and confrontations.

This paper attempts to shed light on the Macroeconomic and social effects of the economic crisis among Member States of the Eurozone in the period 2008-2014, as a result, of the Imperfect Architecture of the Euro (€) and emphasizing, the imperative revision of the framework of the Stability and Growth Pact. Particular emphasis is given to the growing economic and social imbalances between Euro (€) North and Euro (€) South. More specifically, in the comparative analysis of economic and social imbalances, this paper focuses on a representative sample of selected Euro (€) North (Germany, France, Netherlands, Belgium, Luxembourg, Austria and Finland), and respectively Euro (€) South (Greece, Italy, Portugal, Spain and Cyprus) countries drawing useful conclusions.

The structure of the present study is as follows: Section 2 presents an overview of structural and institutional weaknesses of the Eurozone, in the initial function period (1999 - 2007), highlighting the absence of strategic planning, the leadership deficit, as well as the lack of a program to respond to economic crises, and demonstrating in Section 3 the environment of "Secular Stagnation" that the Eurozone had entered in the first period of economic crisis (2008 - 2014). Section 4 reflects the Macroeconomic imbalances between Member States of the Euro (€) North and South and also the difference in competitiveness levels. Section 5 outlines the consequent increase in income inequality, poverty rates and social risks, which poses a serious threat to social cohesion. Section 6 highlights the social imbalances. Finally, Section 7 is dedicated to conclusions.

2. Overview of the structural and institutional weaknesses in the Eurozone in the Pre - Economic Crisis period (1999 - 2007)

2.1 Economic factors and policy issues

In the Pre - Economic Crisis period (1999 - 2007) the Imperfect Architecture of the Euro (€) is clearly reflected, in short, by the absence of full Economic integration and therefore in the failure to provide a centrally-designed budget and a commonly adopted income redistribution mechanism among Member States, as well as in the failure to create a European Monetary Fund (EMF) and in the absence of a "Lender of Last Resort" by the European Central Bank (ECB) in order to deal with asymmetric

Economic shocks caused by external factors. Thus, the deepening of the economic crisis in the Eurozone (2010-2014) highlighted the structural and institutional weaknesses of this Imperfect Architecture and its asymmetric effects on the Economic, Social and Political fields among Member States (Euro (€) North-South) (Tamourantzis Asimakis, 2019).

Major issues had arisen, such as the Euro (€) states' structural weaknesses in the process toward Euro (€) integration. Economic factors, on the one hand, and Policy issues, on the other, played a key role in this development. In the Economic field, serious problems had arisen due to: a) the Imperfect Architecture of the Euro (€) (characterized by the above-mentioned weaknesses), b) the absence of the Optimum Currency Area (OCA) criteria in the Eurozone (Mundell, 1961, McKinnon, 1963, Kenen, 1969, Ishiyama, 1975, Tower & Willet, 1976, Mongelli, 2002), c) the failure to design an exit mechanism from financial disturbances, d) the inefficiency and inflexibility of the initial framework of the Stability and Growth Pact (SGP - 1997, 2005, De Grauwe, 2014), e) the "conservative" policy of ECB (whose main objective is to stabilize inflation irrespective of employment rates) (ECB, 2006),

As well as Policy issues due to: a) the weaknesses of the institutional framework (lack of planning and preparedness in developing economic and social policies and prevention), b) the leadership deficit and the emergence of economic nationalism traits in some Member States (De Grauwe, 2014), c) the lack of commitment and political determination to implement the objectives of the "Lisbon Strategy" (2000), as harmonization in the context of a dynamic and competitive Europe with emphasis on innovation, sustainable development and social cohesion (European Council, 2000) has not been achieved. In addition, d) the failure of the European Social Model to provide protection from poverty and social exclusion, as well as the inability to adopt a dynamic and productive model in which economic competition, a Social Safety Net, solidarity, the principles of Democracy, Justice, Human Rights and social cohesion (European Commission, 1994) co-exist, combined with e) dysfunctions in the Eurozone decision-making mechanism and the political leaders' timidity in searching for an effective, sustainable and acceptable solution, based on reciprocity and solidarity (Skidelsky, 2012) inevitably led the weakest economies (Euro (€) South) to recession with a concurrent increase in Macroeconomic and social imbalances.

Admittedly, the creation of the common currency was based more on nominal convergence criteria (inflation, fiscal budget deficit, public debt, exchange rate stability and long-term interest rates) (Maastricht Treaty, 1992 and SGP, 1997, 2005) and less on convergence factors in the structure of real economies (Current Account Balance, Real GDP, REER, etc.). It seems, however, that nominal convergence cannot endure without first establishing real convergence.

3. The environment of "Secular Stagnation" in the Eurozone (2008 - 2014)

Following the deepening of the economic crisis (2010-2014), the imperfections and weaknesses of the initial structure of the Monetary Union (MU) as well as the absence, of harmonization, of convergence and appropriate economic and financial tools (as outlined above) inevitably led to an environment of either sluggish growth or "Secular Stagnation" (Figure 1) with high unemployment rates and deflation levels. It can be concluded that, unlike the Eurozone, the US and UK economies, with their institutional framework flexibility, coordination of economic policies, and a greater degree of open market index, continue to "lead" World Development. These are depicted by the cumulative growth rate for the period 2008-2014 (Figure 2). Once again it can be seen that the institutional framework in the Eurozone displays faults and imperfections, with very high unemployment rates, considerably weak institutions, great political tensions, and a fragile financial system (Wolff, 2015). It follows, then, that this is not an appropriate model in a world of rapid international developments and with several Member States facing considerable difficulty in returning to pre-crisis (2008) economic growth levels (particularly in the Euro (€) South). As a result, a radical reform is needed (Summers, 2014).

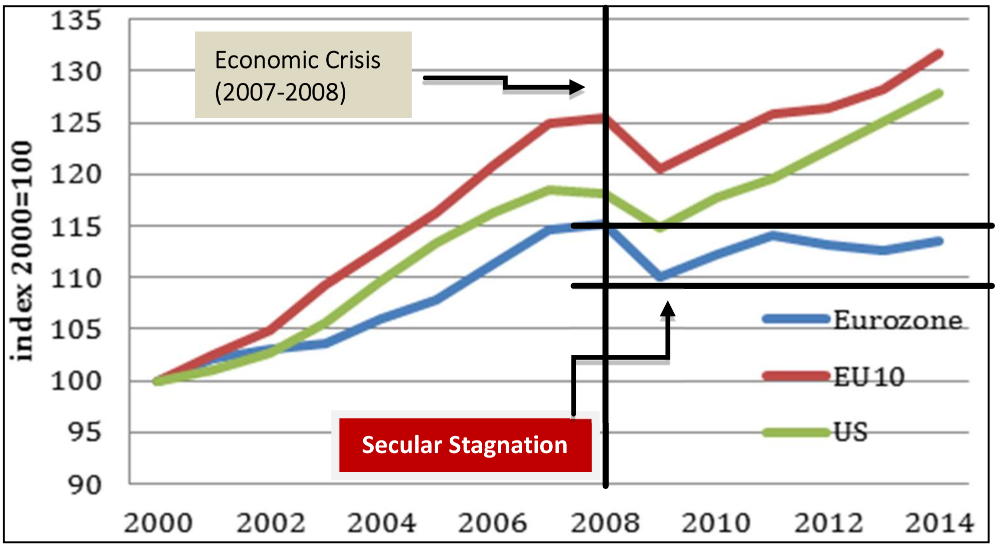

Figure 1. Sluggish Growth rate and Secular Stagnation in the Eurozone (2008-2014)

Source: De Grauwe, 2015, European Commission, AMECO

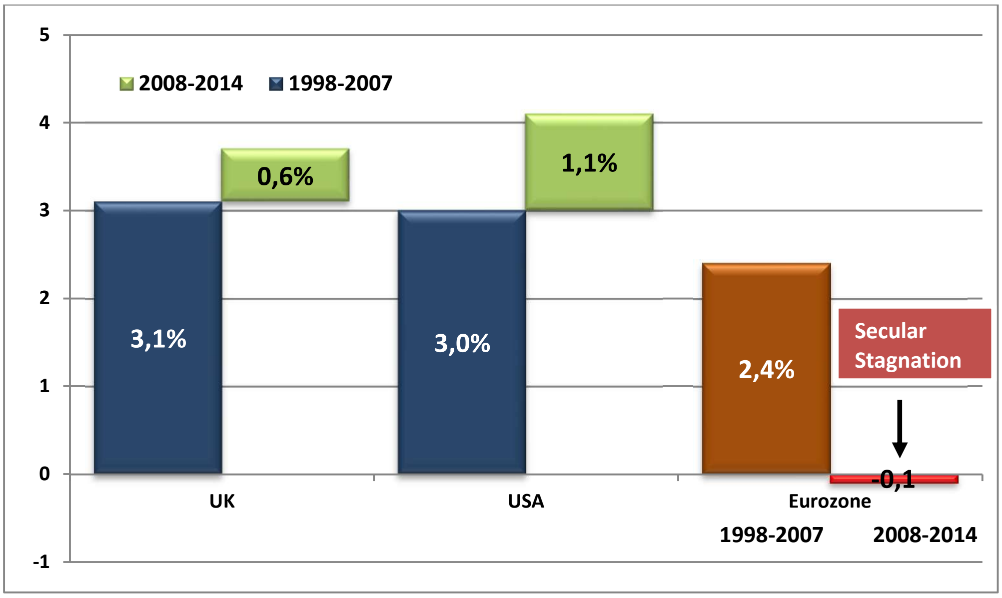

Figure 2. Cumulative Growth rate (%) 1998-2007 and 2008-2014 in the Eurozone (in selected Eurozone countries (Euro (€) North - South)), USA and UK

Source: The Conference Board, Total Economic Databace and author's calculations

4. Macroeconomic imbalances in the Eurozone and the Competitiveness gap among Member States (Euro (€) North - South)

4.1 The case of Current Account Balance

The increasing widening of Macroeconomic imbalances in the Eurozone Member States are depicted by a combination of deficits and surpluses in the individual current account balances, reflecting, on the one hand, differences in the level of Competitiveness and on the other hand, affecting the level of Output (GDP) and Employment. They mainly come from the high Trade Balance deficit and reflecting not only cyclical factors but also structural weaknesses of the production base. Their persistent widening suggests that the current account deficits are caused by a combination of structural determinants and imbalances, and they are not related to economic factors.

The participation in a MU, may contribute the formation of current account imbalances in the Member States through two main channels: a) The first channel, refers on the economic shocks (Demand-Supply) that affect the individual Member States and as a result, leads to the creation of the current account imbalances due to the rigidity of the nominal exchange rates, with a direct impact on a slowdown in the pace of the adjustment to economic shocks. b) The second channel is related both to the increasing Financial integration and increasing Capital mobility, where subsequently, it leads to the increase of Credit expansion resulting in the creation of long-term imbalances in the individual current account balances. Figure 3 shows the increasing expansion of Macroeconomic imbalances in selected Member States of the Eurozone (Euro (€) North-South) during the period 2002-2014, reflected by a combination of deficits and surpluses in the individual current account balances which illustrate: a) the structural weaknesses in the Eurozone Architecture (from as early as the first years of adopting the Euro (€), b) differences in competitiveness levels and c) differences in the open market index among Euro (€) economies (Figure 4) (which confirms absence of a basic OCA criterion, (McKinnon, 1963, Krugman, 1991, De Grauwe, 1996)). These weaknesses and differences affect Output (GDP) and Employment levels among Member States.

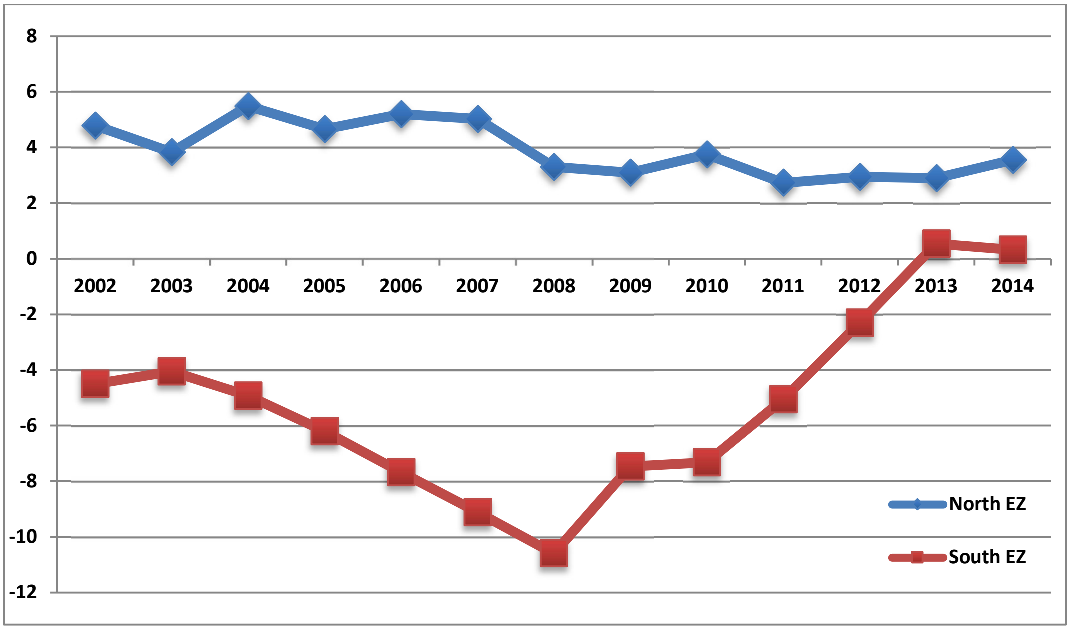

Figure 3. Current Account Imbalances (% GDP), 2002-2014 in selected Eurozone countries, (Euro (€) North - South)

Source: IMF and author's calculations

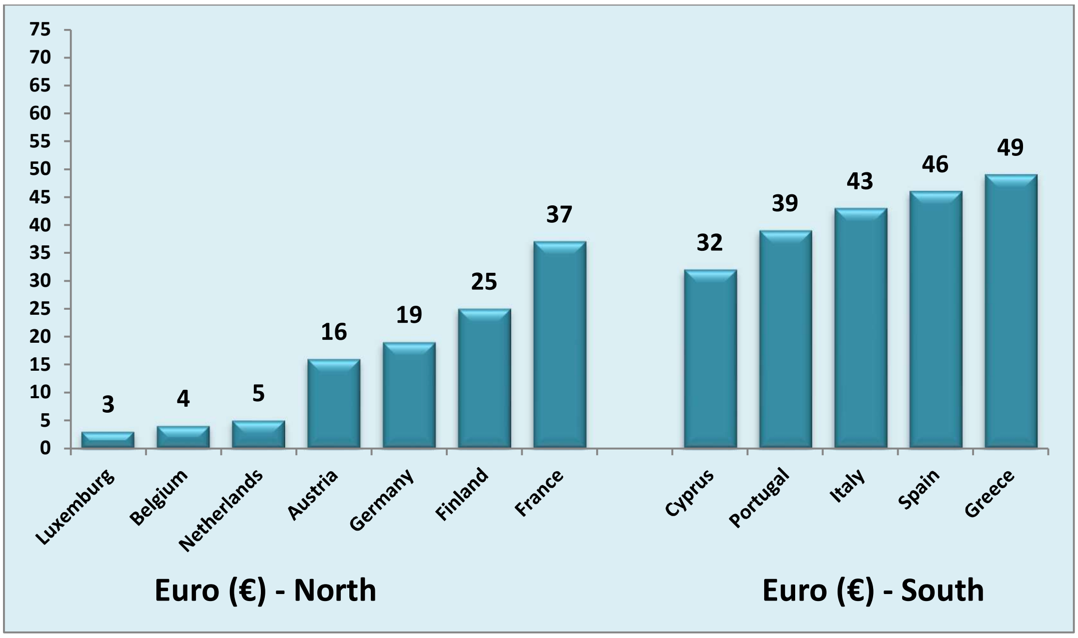

Figure 4. Open Market Index, Rank (2015) in selected Eurozone countries, (Euro (€) North - South)
Source: ICC, Open Markets Index 2015

Undoubtedly, the high and persistent current account deficits limit the scope for economic growth and implementation of stabilization and development policies. Moreover, they are a cause for serious concern, especially when issues of economic prospects are raised both in an MU environment and in individual Member States. Persistent increases in current account deficits suggest that these are caused by combinations of structural parameters, on the one hand, and imbalance determinants, on the other, and that they are not related to cyclical factors (Anastasatos, 2008).

4.2 Asymmetric effects on the Eurozone countries (2008 - 2014)

As mentioned above, in an Imperfect MU environment, in cases of asymmetric shocks with no harmonization and convergence of economic policies at central level, a "conservative" ECB faces tremendous difficulty in stabilizing GDP and Employment levels and is inevitably led to "paralysis" (De Grauwe, 2014). Moreover, with the creation of the Euro (€), the Imperfect Architecture meant that in an environment of Macroeconomic imbalances, reduced mobility of production factors and limitation of fiscal policy rates, the weight of the real adjustment was transferred to Member States and more specifically to their structural policy (even in addressing individual surpluses) and to "Internal Devaluation" during periods of decreasing or low Competitiveness levels (Wyplosz, 1997). Consequently, as shown by the Progress Adjustment Index (The 2014 Euro Plus Monitor) (Figure 5), the recent experience of 2010-2014 establishes that the burden of adjustments is exclusively borne by debtor countries (Defaulter Member States - (Euro (€) South)), as opposed to creditor countries (Surplus Member States - (Euro (€) North), thus exacerbating the situation and creating a downward deflationary trend with rising unemployment rates and lack of economic growth, economic recession and uncertainty and social instability, which had condemned the Eurozone to a "Secular Stagnation" environment (De Grauwe, 2015).

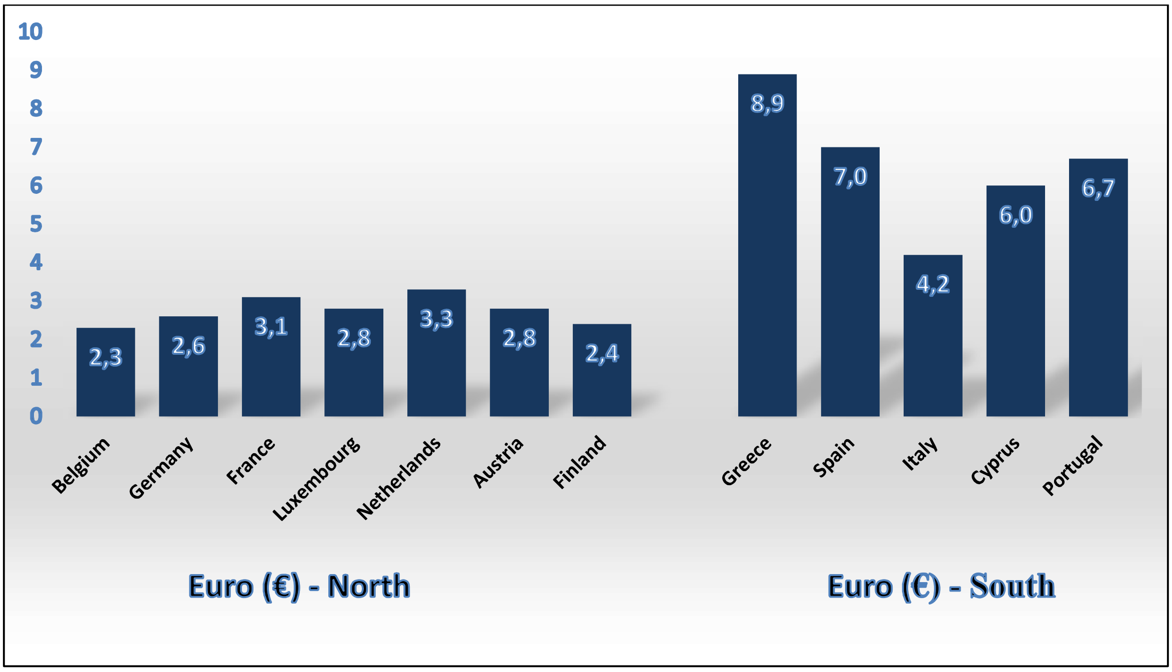

Figure 5. Progress Adjustment Index (2014) in selected Eurozone countries, (Euro (€) North - South)
Source: The Euro Plus Monitor (2014)[2] - The Lisbon Council and Berenberg Bank

[2] http://www.lisboncouncil.net/publication/publication/120-the-2014-euro-plus-monitor-.html

Furthermore, a study by the European Centre for the Development of Vocational Training (Cedefop, 2015) reveals, such as depicts in Figure 6, an unequal recovery in employment levels in the Eurozone, with considerably low employment rates in Member States of the Euro (€) South and projections that pre-crisis (2008) levels will be reached in no less than a decade, in contrast, employment rates in the Euro (€) North Member States have risen to almost pre-crisis (2008) levels. The problem of "Hysteresis" in unemployment[3] is, therefore, a crucial factor resulting from the increased heterogeneity of Member States and seriously inhibiting an increase in employment rates.

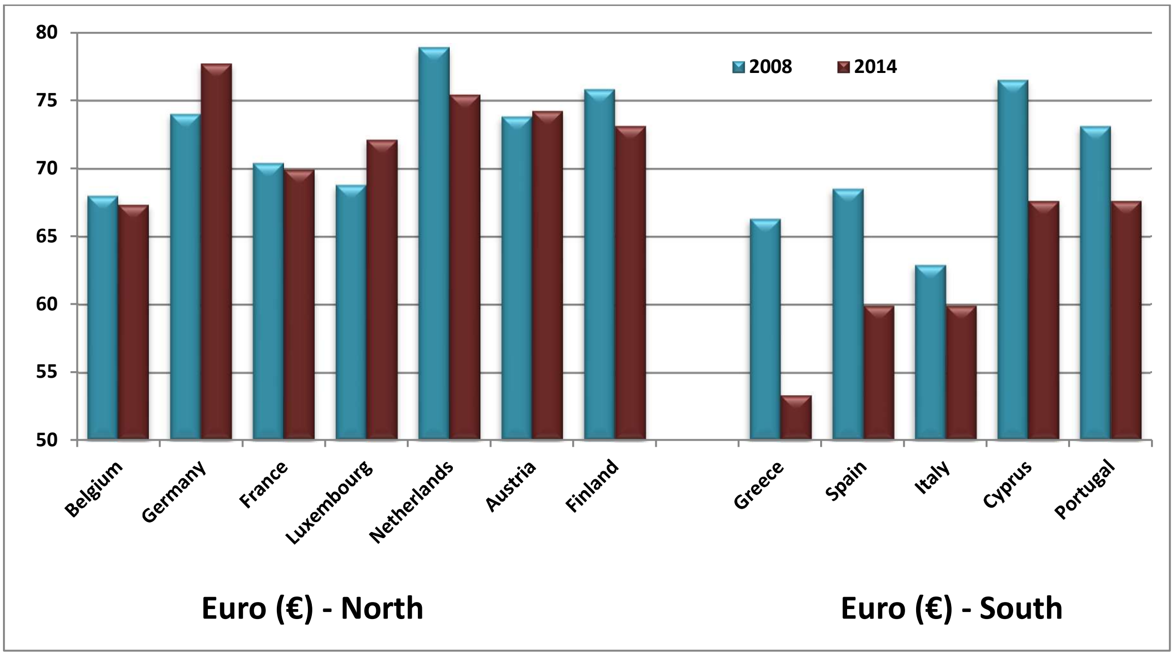

Figure 6. Employment level, 2008 and 2014, in selected Eurozone countries, (Euro (€) North - South), (Percentage (%) of people of working age 20-64, out of all working age population)
Source: Eurostat

5. The Economic Inequality in Eurozone countries (2008 - 2014)

The low Macroeconomic performances in the countries of the Euro (€) South (as outlined above) necessitated within the guidelines of a new model of cooperation between the European Commission (EC), the IMF and the ECB (EC-IMF-ECB) the launch of an "Internal Devaluation" process, as a result on the one hand, of the Imperfect Architecture of the Euro (€) and on the other hand, of the absence of the appropriate economic and financial tools. The key objectives of the program are: a) to reduce fiscal deficits and public debt rates to sustainable levels, b) to reduce current account deficits to sustainable levels, c) to implement structural reforms enabling the Euro (€) South economies to become more

[3] https://www.ecb.europa.eu/press/key/date/2014/html/sp140822.en.html

efficient and competitive, and d) to achieve financial stability, aiming mainly the Euro (€) South Member-States' return to the Financial Markets (Parliamentary Budget Office, 4th Quarter Report, 2013, Matsaganis, 2015).

However, owing to inflexibility of the framework of the Stability and Growth Pact the economic policies of "Internal Devaluation" inevitably had steered the Eurozone adopting policies that are at odds with the concepts of increasing Demand, stimulating employment, strengthening the Social Safety Net as well as the concept of income redistribution, all of which would help neutralize social risks and promote a process of economic growth. These results had increased the Economic uncertainty and more challenges for the Eurozone, with several Member States (particularly the Euro (€) South) also facing the risk of social tensions. This situation had further aggravated by developments in the Refugee crisis and the dramatic rise in terrorism, (as is evidenced by the incidents in Paris and London (2015), Nice, Brussels and Berlin (2016)), causing a substantial degree of uncertainty. Unfortunately, as noted in a report by the International Labor Organization (ILO, 2014), policies leading to the shrinkage of organized public welfare signify that an increasing number of citizens in the Euro (€) area are finally faced with poverty and social exclusion. Let us not forget that the goal which stems from the "Europe 2020 strategy" to reduce people at risk of poverty and social exclusion has not yet been achieved.

The "Internal Devaluation" policies had adopted in the period 2010-2014 had contributed to: a) a steady increase in income inequality, as shown by the Gini index (Figures 7 and 8) and S80/S20 index (Figure 9), b) a steady rise in unemployment rates (Figure 10), c) an unprecedented reduction in the cumulative GDP in some Member States (Figure 11) and d) a huge leap in general government gross debt (Figure 12), leading to deeper recession, deflation and intensification of economic and social imbalances within the Eurozone and reflects the gap between Euro (€) North and South Member States. The mentioned above asymmetries of that period, make the discussion of the imperative revision of the framework of the Stability and Growth Pact very important.

As noted in a recent report by the European Fiscal Board, the compliance with the current reference value for Public (General Government) Debt as well as the compliance with the current reference value of Fiscal Budget Deficits, would in the future cause very significant problems both in achieving Economic Growth and in the efforts of individual Member States to achieve the required Fiscal Adjustment, with the visible risk of transmitting secondary adverse effects throughout the Eurozone (European Fiscal Board, 2020).

In addition, in the context of the current debate on the economic governance review, the most important issues raised by the European Commission concern: a) whether progress and effectiveness have been achieved following the revision of the SGP (2011, 2013), b) whether it has been achieved the sustainability of public finances and preventing Macroeconomic imbalances between Member

States, c) whether closer coordination of the economic policies of individual Member States has been achieved and d) whether the promotion of economic convergence between Member States has been achieved (European Commission, (2020) 55 final).

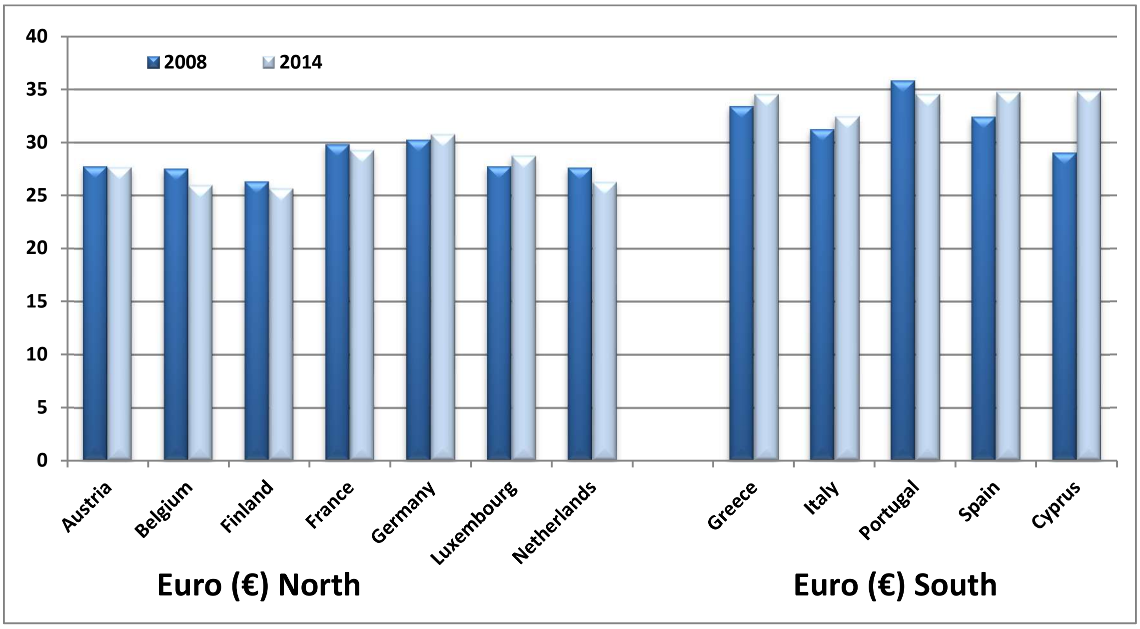

Figure 7. Gini Index, 2008 and 2014 in selected Eurozone countries, (Euro (€) North - South)

Source: Eurostat

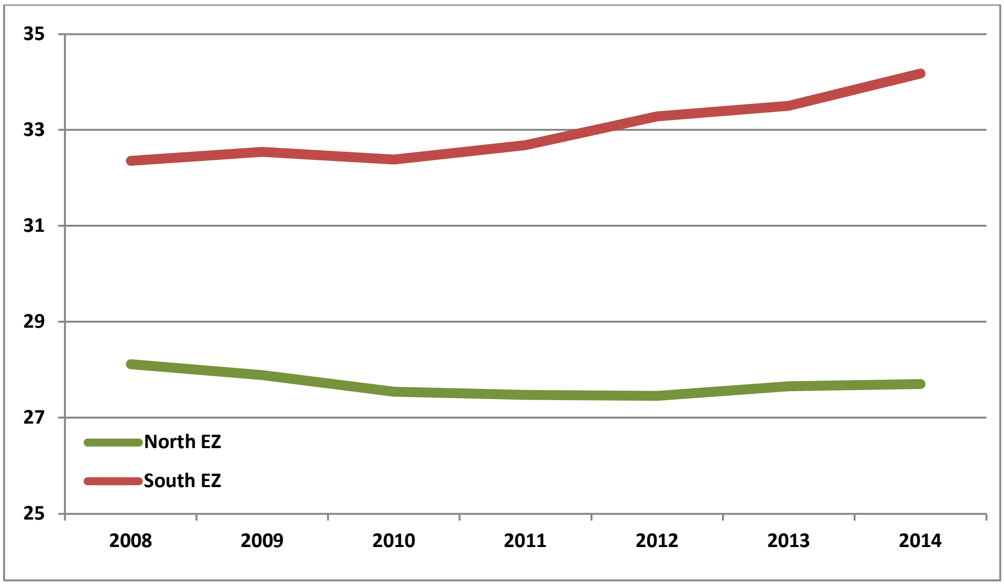

Figure 8. Gini Index, 2008 and 2014 in selected Eurozone countries, (Euro (€) North - South)

Source: Eurostat

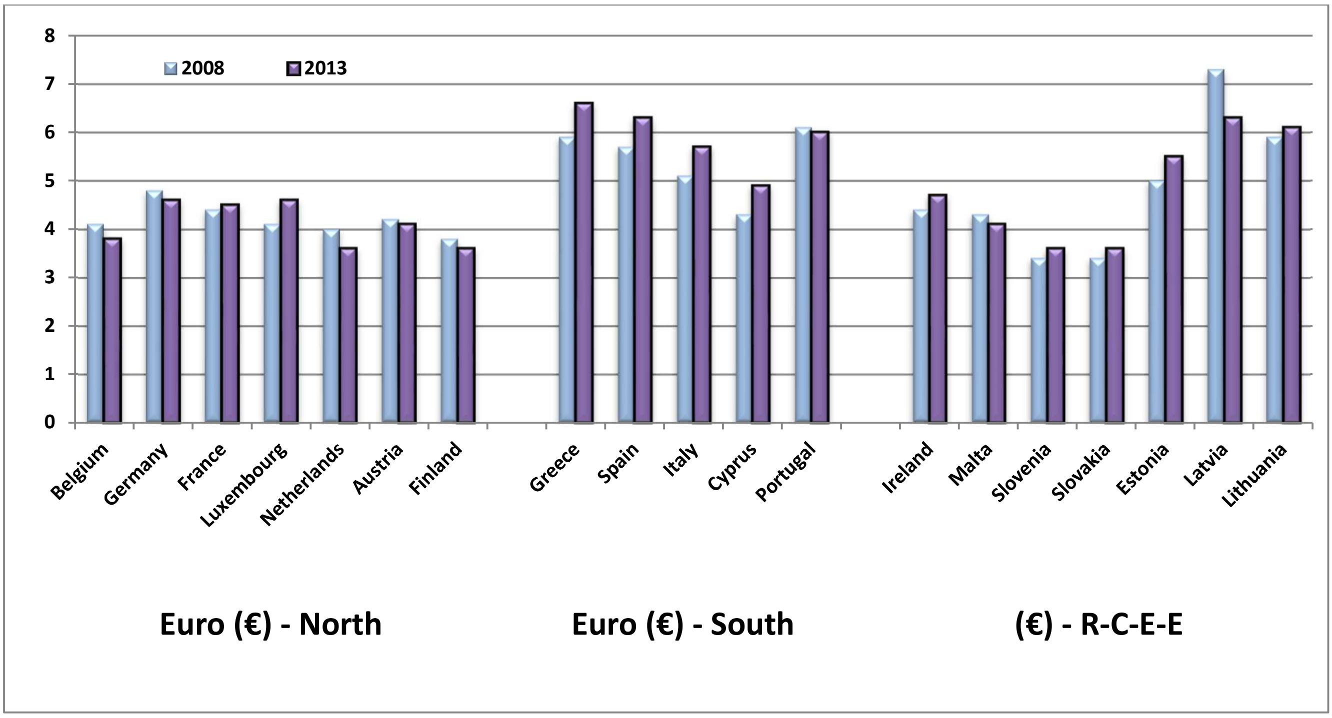

Figure 9. S80/S20 Index, 2008 and 2013 in the Eurozone

Source: Eurostat

***Note: (€) - R-C-E-E: Regional - Central - East - Eurozone

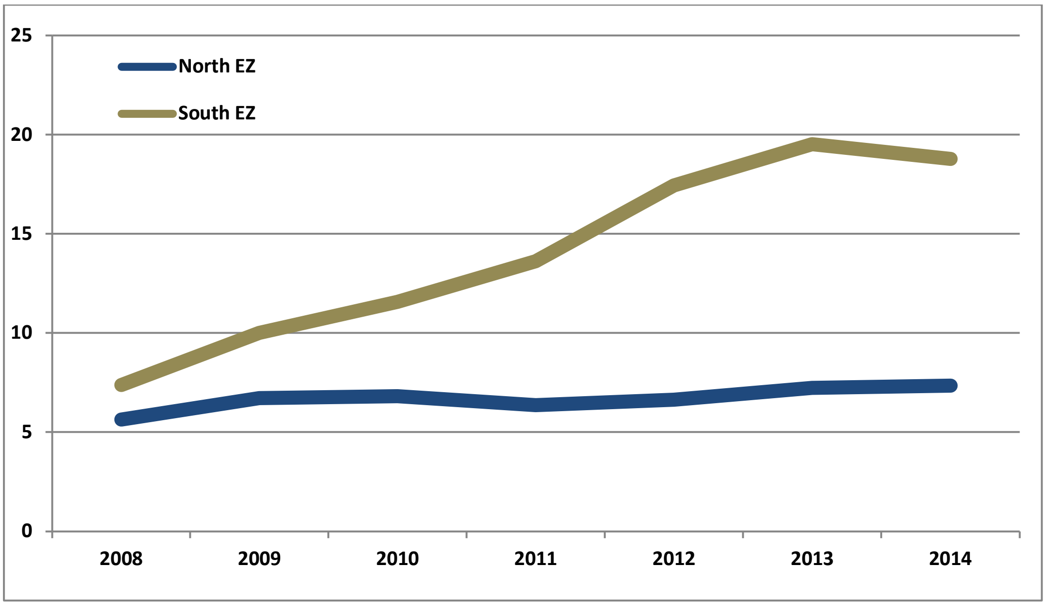

Figure 10. Unemployment Level (%, of total labor force), 2008-2014 in selected Eurozone countries, (Euro (€) North - South)

Source: IMF

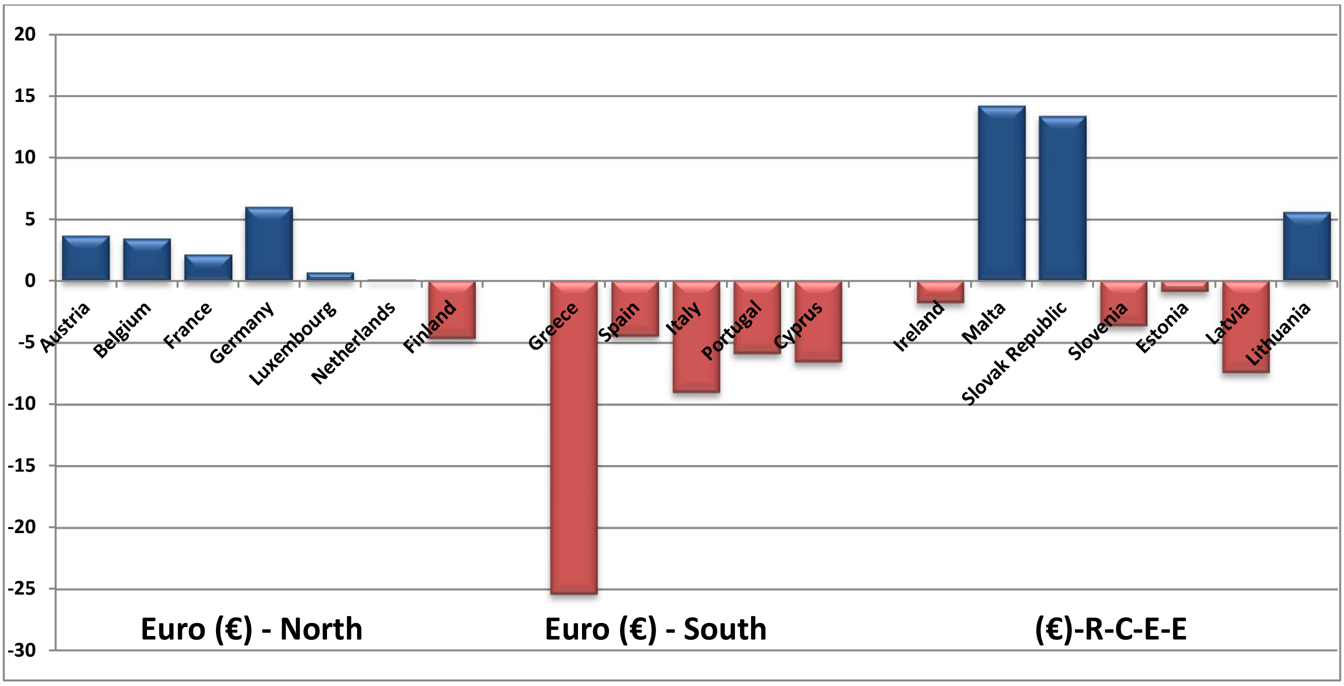

Figure 11. Cumulative GDP, (2008-2014) in the Eurozone

Source: IMF and Eurostat

***Note: (€) - R-C-E-E: Regional - Central - East - Eurozone

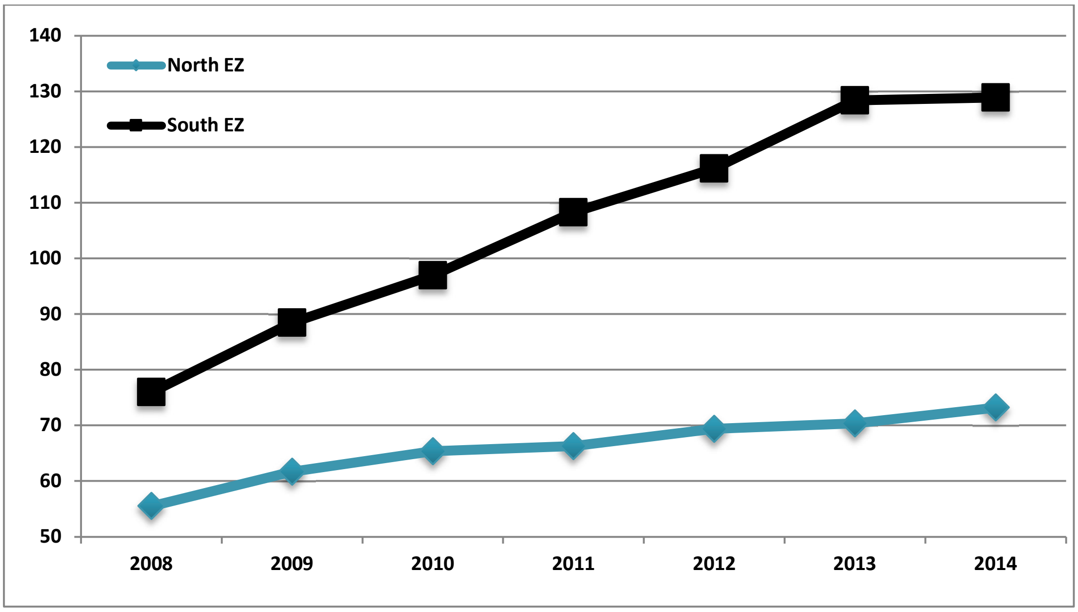

Figure 12. General Government Gross Dept (% GDP), 2008-2014 in selected Eurozone countries, (Euro (€) North - South)

Source: IMF and AMECO

According to Robert Barro, in order to raise tax revenue, countries suffering high levels of general government debt will inevitably direct their economic policy to reducing expenditures and increasing tax rates, thus causing a significant decline in economic activity (Wyplosz, 2010). Therefore, the recent Eurozone crisis experience (2010-2014) leads us to conclude that a reform in the existing tax system is necessary, a reform that will be in favor of income redistribution and will play a key role in the development of the Eurozone. Remarkably, since 2010 we have witnessed increasing reliance on taxation in parallel with a significant reduction in wages and pensions and soaring unemployment rates in the context of the 'Fiscal Consolidation' policies. This situation has led to a deterioration in the living standards of Eurozone citizens and has weakened the social tissue, especially in the Euro (€) South. A OECD report (Taxing Wages 2014) confirms over-taxation levels, especially in the Euro (€) South (Figure 13) at that period. Significantly, the IMF admitted that income inequality is highly detrimental as it undermines development, economic and political stability, social cohesion, and investments (Ostry - Berg and Tsangarides, 2014).

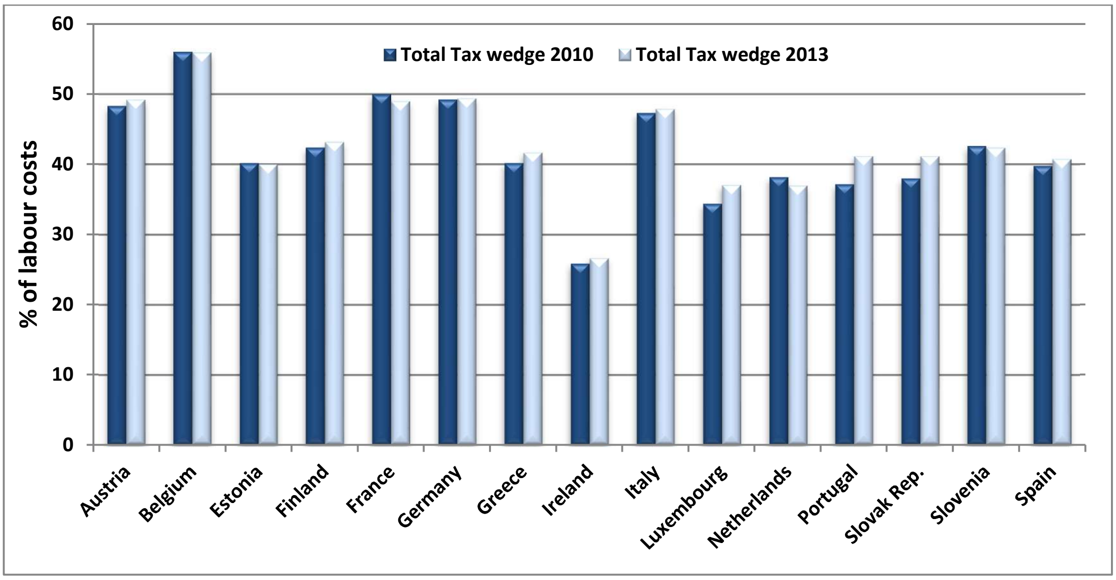

Figure 13. Total Tax Wedge, 2010 and 2013 in the Eurozone

Source: OECD

In conclusion, in order to a "Fiscal Consolidation" program be sustainable a Social Safety Net must exist that is aimed at ensuring the vulnerable groups of the population (Blanchard-Cottarelli, 2010). In particular any successful "Fiscal Consolidation" program should: a) rely more on spending cuts than on tax increases, b) base expenditures on fiscal rules and clear goals and c) be compatible with the monetary policy. The chances of success of such programs tend to increase when social benefits (in terms of poverty reduction) are clearly addressed and when there is increasing investment in Active

Labour Market Policies programs, vocational training and tax rate reduction, e.g. a reduction in the VAT rate on a standard basket of essential goods such as foods (Kaplanoglou - Rapanos and Bardakas, 2014). Therefore, in addition to maintaining social cohesion, providing support to the weaker sections of society in times of “Fiscal Consolidation” is vital for program effectiveness and a sustainable reduction in budget deficits and public debt (Parliamentary Budget Office, 4th Quarter Report, 2013).

6. Social imbalances in Eurozone countries

6.1 The social justice and the social divide

The economic and social interdependence in the context of economic globalization combined with the deepening of the economic crisis (2010-2014) posed multiple risks to the Eurozone: in economic terms: a) increasing levels of Macroeconomic imbalances between Euro (€) North - South and b) widening of the competitiveness gap. In social terms: a) soaring income inequality, b) a rise in social risks and poverty levels, and c) a rising risk of exclusion for people and communities, threatening the viability of the Euro (€) Architecture. The above-mentioned social risks are established by the results of “Misery Index” (Table 1), which clearly display the social imbalances between Euro (€) North - South Member States. The inefficiency of a Social Safety Net to the weaker sections of society is reflected by the widening of the social divide between Euro (€) North - South, as described by the European Social Justice index in Figure 14, constituting a threat to the structure of Euro (€) integration (Bertelsmann, 2014a).

Rank (Worst to Best)	Country	Misery Index Score	Largest Contribuiting Factor
16	Spain	34,32	Unemployment
19	Greece	32,02	Unemployment
20	Cyprus	31,55	Unemployment
40	Portugal	22,53	Unemployment
55	Italy	18,08	Unemployment
71	France	14,17	Unemployment
79	Belgium	12,22	Unemployment
81	Finland	11,79	Unemployment
90	Netherlands	9,94	Unemployment
98	Austria	7,63	Unemployment
99	Germany	7,62	Unemployment

Table 1. “Misery Index” (2014) in selected Eurozone countries, (Euro (€) North - South)

Source: World Bank, Economic Intelligence Unit (EIU), IMF

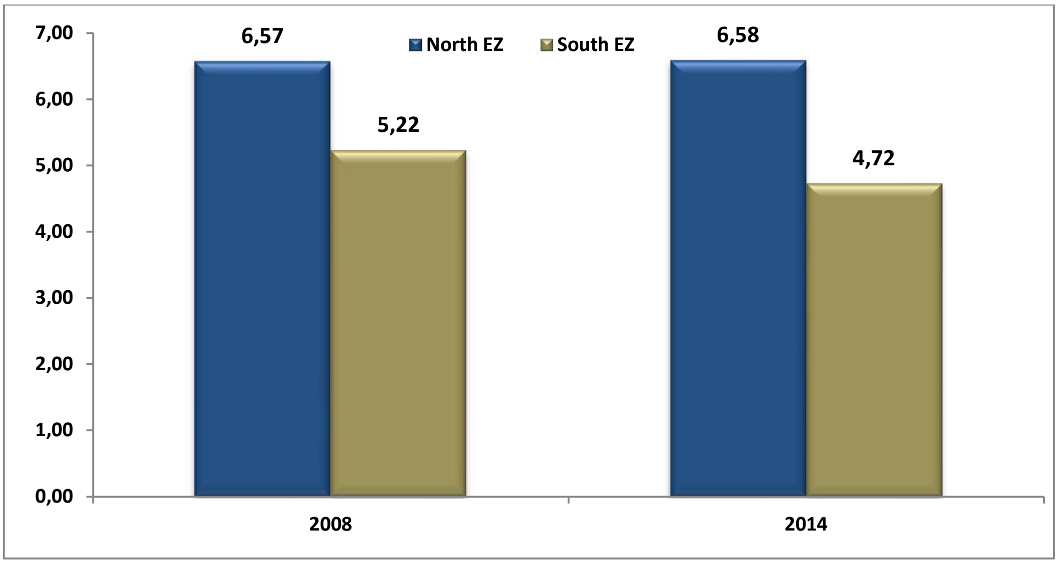

Figure 14. European Social Justice Index[4], 2008-2014 in selected Eurozone countries, (Euro (€) North - South)

Source: Bertelsmann Stiftung, 2014

6.2 The effects of Income Inequality in Social Cohesion

The widening social gap, the deficit in social guarantees and social participation opportunities alongside the economic fragmentation between the Euro (€) North and South, as presented above, had caused a corresponding fragmentation within societies, socio-economic imbalances and increasing income inequality. These developments imply a significant effect on future growth prospects of Euro (€) economies and on the sustainability of funding social policies. Economic development is crucial not only for addressing the continuing effects of the crisis but also for promoting economic and social prosperity, social cohesion and for fighting poverty while addressing the social and political risks (Pagoulatos, 2014).

A very important determinant of the social cohesion indicator is GDP per capita. The differences in levels of income that are reflected in GDP per capita between Eurozone Member States (Figure 15) constitute an important determinant in maintaining social cohesion. It is crucial to see that the income level of Euro (€) North is almost 100% higher than the income level of Euro (€) South. According to a report by the Bertelsmann Stiftung (2014b), the three major socio-economic factors which determine social coherence are: a) GDP per capita, b) income inequality (as reflected by the Gini coefficient and

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[4] http://www.bertelsmann-stiftung.de/en/press/press-releases/press-release/pid/social-imbalance-in-europe-is-increasing/

S80/S20[5]) and c) economic growth rate. The greater an individual Member State's GDP is, the higher its social cohesion. Income inequality is inversely correlated with social cohesion; that is, inequality between communities results in lower levels of cohesion.

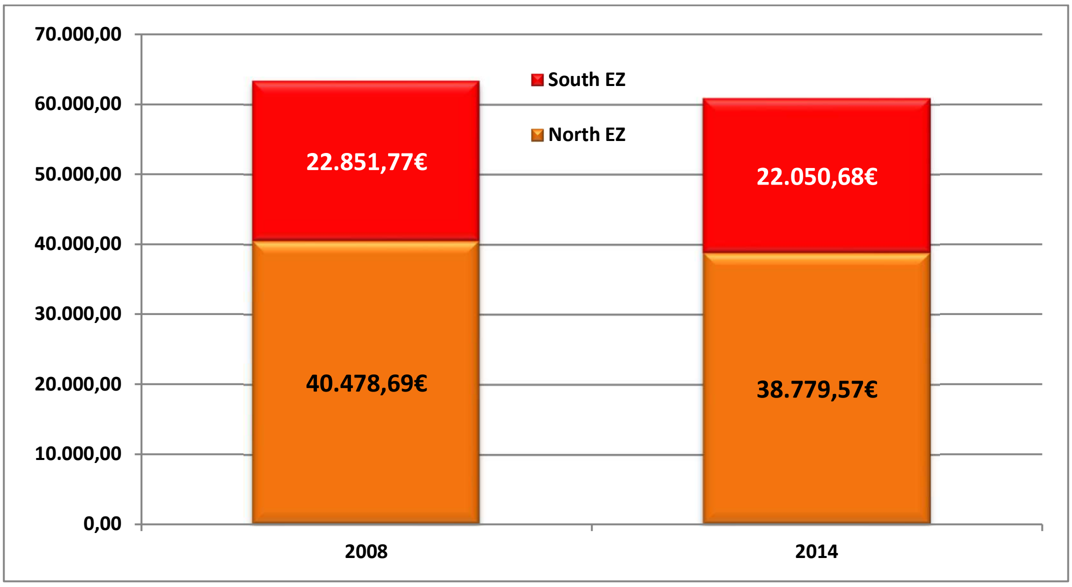

Figure 15. GDP per capita, 2008-2014, in selected Eurozone countries, (Euro (€) North - South)

Source: IMF

7. Conclusion

This paper Is referred on the Macroeconomic and social effects of the economic crisis among Member States of the Eurozone in the period 2008-2014, as a result, of the Imperfect Architecture of the Euro (€) and emphasizing, the imperative revision of the framework of the Stability and Growth Pact. The comparative analysis focuses on a representative sample of selected Euro (€) North and Euro (€) South countries.

The Macroeconomic imbalances, as presented above and the long-standing weaknesses of the Euro (€) Social State have undermined social cohesion. Income inequality and rising levels of unemployment and poverty among Member States are responsible for the economic, social, and political tensions.

[5] The most widespread income inequality indicators are: the S80/S20 ratio, which measures the ratio of the income of the richest quintile of the population to the income of the poorest quintile and the Gini index which ranges between 0, when all people have the same income (full equality) and 1 when the total of disposable income is held by one person (maximum inequality). The sensitivity of the Gini index is greater in the middle of income distribution, rather than towards the ends.

Undoubtedly, the response to the economic crisis in the Eurozone requires a regulatory model which will provide a stable and flexible guidance framework.

In conclusion, it is established that the survival of the common currency requires the effective implementation of economic and social policies, aimed at Macroeconomic Stabilization and emphasizing policies which support Employment and Economic Growth, enhancing Eurozone governance with stronger institutions which will be subject to Democratic control. In other words, we need the policy mix that would ensure equilibrium between Euro (€) Institutions and all the restrictive rules for the implementation of national policies (Tsoukalis, 2014), aiming for greater economic flexibility and better social protection.

In addition, a coordinated policy is needed against protectionism and economic nationalism which will ensure prosperity, social justice, sustainable development, and Democratic legitimacy and will be based on values and principles. It is also imperative that we develop a sustainable social security system, regional balance mechanisms and a sustainable tax system based on performance and free of distortions. Focusing on social peace and social cohesion, such policies can greatly contribute to the Economic and Social sustainability that is necessary for deepening the Eurozone.

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