

CONFERENCE PROCEEDINGS

EUROPE AT THE CROSSROADS

A Union of Austerity or Growth Convergence?

Athens, Greece

November 21–22, 2014



Levy Economics Institute of Bard College

A conference co-organized by the Levy Economics Institute of Bard College and *economia civile* with support from the Ford Foundation, the Friedrich-Ebert-Stiftung, and Marinopoulos AE

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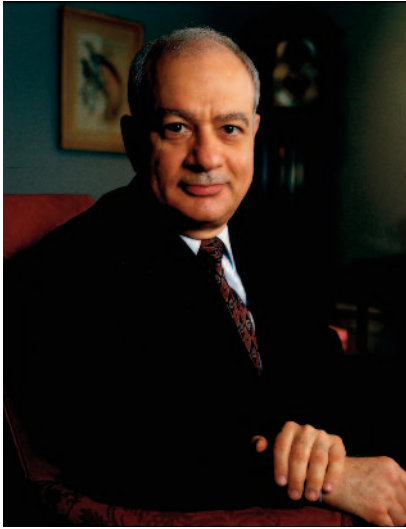
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These proceedings consist of edited transcripts of the speakers' remarks and summaries of session participants' presentations.

Foreword



I am delighted to welcome you to the conference “Europe at the Crossroads: A Union of Austerity or Growth Convergence?” organized by the Levy Economics Institute and Economia Civile with support from the Ford Foundation, the Friedrich-Ebert-Stiftung, and Marinopoulos AE. This conference is one of the public outreach activities of the joint Ford–Levy Institute Project on Financial Instability, which draws on Hyman Minsky’s extensive work on the structure of financial systems to ensure stability, and on the role of government in achieving a growing and equitable economy.

Among other key topics, the conference will address the continuing debate surrounding the eurozone’s systemic instability; proposals for banking union; regulation and supervision of financial institutions; monetary, fiscal, and trade policy in Europe, and the spillover effects for the US and the global economy; the impact of austerity policies on US and European markets; and the sustainability of government deficits and debt.

I trust you will enjoy the presentations that follow. As always, your comments and suggestions are welcome.

Dimitri B. Papadimitriou
President, Levy Economics Institute

Program

Friday, November 21

8:30–9:30 a.m.

REGISTRATION

9:30–9:45 a.m.

WELCOME AND INTRODUCTION

Dimitri B. Papadimitriou, *President, Levy Institute*

9:45 a.m. – 12:00 p.m.

SESSION 1

European Monetary Policy and Market Flexibility

Moderator: Nikos Chrysoloras, Greece and Cyprus Bureau Chief, *Bloomberg News*

Emilios Avgouleas, Chair, International Banking Law and Finance, University of Edinburgh

“Free Movement of Capital in an Imperfect Monetary Union: Any Remedies?”

Lex Hoogduin, Professor of Complexity and Uncertainty, University of Groningen

“ECB Monetary Policy: Between a Rock and a Hard Place”

Mario Tonveronachi, Professor of Financial Systems, University of Siena

“Making the ECB the Central Bank of a Nonfederal State”

1:30–3:30 p.m.

SESSION 2

How to Build a Stable European Financial System: The Central Banker’s View

Moderator: Viktoria Dendrinou, Correspondent, *The Wall Street Journal*

Patrick Honohan, Governor, Central Bank of Ireland

“Better Eurosystem Performance: What Roles for Financial Engineering, Monetary Policy and Politics?”

Marek Belka, Governor, National Bank of Poland

“Monetary Policy in a Non-euro EU Country: Challenges and Opportunities”

Lubomír Lízal, Member of the Board, Czech National Bank

4:00–6:30 p.m.

SESSION 3

Can the Periphery Countries Return to Growth?

Moderator: George Skafidas, Journalist, *Ethnos*

Stuart Holland, Professor, University of Coimbra; Senior Scholar, Institute for Social and European Studies, Hungary

“Europe in Question—And What to Do About It”

Megan Greene, Chief Economist, Manulife Asset Management

“Eurozone: A Japanese-style Lost Decade?”

Michalis Nikiforos, Research Scholar, Levy Institute

“‘Twin Deficits’ in Greece: In Search of Causality”

Eckhard Hein, Research Associate, Levy Institute; Professor of Economics, Berlin School of Economics and Law

“Coping with Imbalances in the Euro Area: Policy Alternatives Addressing Divergences and Disparities Between Member Countries”

Saturday, November 22

9:00–11:30 a.m.

SESSION 4

Threats to European Recovery

Moderator: Alexis Papahelas, Executive Editor, *Kathimerini*

Elga Bartsch, European Chief Economist, Morgan Stanley

“European Economics: Waiting for the Credit Impulse to Kick In”

Peter Bofinger, Member of the German Council of Economic Advisers; Professor of Monetary Policy and International Economics, University of Würzburg; Research Fellow, Centre for Economic Policy Research

“Macroeconomic Policies for European Growth”

Engelbert Stockhammer, Professor of Economics, Kingston University

“Exports, Debt, and Austerity: Comments on the Dysfunctional Economic Policy Regime of Europe”

Andrea Terzi, Professor of Economics, Franklin University Switzerland and Catholic University, Milan

“The Fiscal Instrument: How It Got Lost and How It Can Be Reclaimed”

11:30 a.m. – 1:00 p.m.

SESSION 5

Responding to the Challenge of European Unemployment

Moderator: Kostas Kalloniatis, Journalist, *Eleftherotypia*

Steven Tobin, Senior Economist, Research Department, International Labour Organization

“Building a Job-rich Recovery in Europe”

Rania Antonopoulos, Senior Research Associate, Levy Institute; Macroeconomic Policy Adviser, UN Women

“After Austerity: Measuring the Impact of a Job Guarantee Policy for Greece”

2:30–4:30 p.m.

SESSION 6

Austerity and Growth: An Impossible Alliance?

Moderator: Joanna Kakissis, Athens Correspondent, National Public Radio (US)

Heiner Flassbeck, formerly Director, Division on Globalization and Development Strategies, UNCTAD, and Deputy Finance Minister, Germany
“Why Structural Reforms and Fiscal Soundness Hamper Growth”

Jan Kregel, Senior Scholar, Levy Institute; Professor of Finance and Development, Tallinn University of Technology

“Financial Fragility and the Single Currency”

Stephen Kinsella, Lecturer in Economics, Kemmy Business School, University of Limerick

“Ireland: Europe’s Poster Child for Austerity Post Crisis?”

4:30–5:30 p.m.

KEYNOTE SPEAKER

Yannis Dragasakis, *MP (SYRIZA) and Vice President of the Hellenic Parliament*

6:00–8:00 p.m.

SESSION 7

The Ongoing Greek Crisis: What Is to Be Done?

Moderator: Suzanne Daley, Europe Correspondent, *The New York Times*

Giorgos Argitis, Professor of Economics, University of Athens; Scientific Director, Institute of Labour, GSEE

“The Alternative Policy of INE-GSEE for the Greek Economy to Exit the Crisis”

Panagiotis Liargovas, Director of the Budget Office, Greek Parliament; Jean Monnet Chair in European Integration and Policies, University of Peloponnese

“Greece’s Fiscal Adjustment Program: Success or Failure?”

Dimitri B. Papadimitriou, President, Levy Institute

“Is Greece Heading for a Recovery?”

Welcome and Introduction

DIMITRI B. PAPADIMITRIOU

President, Levy Institute



Good morning, ladies and gentlemen. I want to welcome you and thank you for coming. I want to express a special welcome to our speakers, some of whom have come from faraway places, to this second Hyman Minsky Conference coorganized by the Levy Economics Institute in New York and *Economia Civile*, with the support of the Ford Foundation, the Friedrich-Ebert-Stiftung, and Marinopoulos AE.

Many thanks are also due to Chronis Polychroniou for his tireless efforts in dealing with the logistical details here in Athens, and, of course, many thanks also to our media sponsors,

among which Ethnos, Imerisia, Eleftheros, Ependysi, Typos tis Kyriakis, Eleftherotypia, Direction, Capital.gr, and Hit&Run.gr

The conference is one of the international activities of the Levy Economics Institute—specifically, the Institute’s research program on monetary policy and financial structure, headed by the Institute’s long-time senior scholar, Jan Kregel. Kregel, who was chosen by the president of the United Nations General Assembly’s Commission on Reform of the International Financial System, served as rapporteur. He’s a close follower of Hyman Minsky. Minsky, for those of you who do not know enough about him, was a maverick economist who is well known in the economics profession for his work on financial instability and employment policies, and [whose] many and prescient contributions to economics have finally been recognized not only in the United States and Europe, but all over the world.

The Levy Institute, for those of you who have not followed our work, was established in 1986 as a unit of Bard College in New York. It is an independent, nonprofit, nonpartisan public policy think tank that encourages diversity of opinion in the examination of economic issues profoundly affecting countries all over the world. We’re concerned with financial instability; the capital development of the economy; growth and employment; the purchasing power of workers; the distribution of income, wealth, and well-being; and gender equality. Our focus is on generating viable, effective public policy responses to pressing economic problems. In our conferences and other events, we bring together academics, business leaders, policymakers, and concerned citizens to debate—and many times, to argue against—dominant ideas in the hope of serving the public interest. We invite you to take a look at some of our work that has been printed and is available outside on the tables. Those publications are related to the topics of this conference, and, if you don’t wish to take paper with you, you can visit our website, where, just for statistical purposes, ... more than 750,000 pages per month have been downloaded.

The purpose of this conference is to broaden the discussion relating to the crisis in Greece and the eurozone to [include] a wider audience interested in understanding the root causes of these crises from the perspective of careful research and analysis, and to consider alternative policies. My colleagues and I have argued [since] as early as 2010 that the diagnosis of the crisis and the corrective actions demanded by the troika and [implemented] by three successive governments in Greece were ill conceived. As we hope to show tomorrow through our specially constructed macroeconomic model for Greece, the prospects for the country, despite the incipient recovery, are not very encouraging should business continue as usual.

The simulated trajectories of the financial balances for the three main sectors of the economy for the next three years differ significantly from those suggested by the troika and the Greek government. High public deficits and debt, together with bad policies, have created unstable markets. The ineffective and disastrous austerity policy responses and miscalculated fiscal multipliers have delivered catastrophic levels of unemployment, economic downturn, declining fortunes, high levels of poverty, and despair. Euphoric periods with accommodative monetary and fiscal policy helped increase both the government and private sector's borrowing and debt, linked to the deterioration in the balance of payments. Indeed, there is a connection linking the internal sectors—that is, private and public—with the external sector. And although this connection—or macroeconomic identity, as it is known in economics—is not a theory, it informs policy. My colleague Jan Kregel and others will elaborate on this issue in the panels to follow.

A year ago, we organized a similar conference here in this facility to investigate the cause of the continuation of the economic and financial crisis, and to determine the effectiveness of the policies that had been followed. Now, a year later, the eurozone's periphery member-states' sovereign debt has grown larger, despite the austerity imposed by Berlin and Brussels. Debt dynamics are complex, but the debt level of the Southern European periphery is accumulating at an accelerating pace—for Greece, for example, it is € 340 billion, representing over 170 percent of GDP.

What has become clear, however, is that austerity means falling employment, wages, and pensions that are reducing consumption and retail sales and hence government revenues, necessitating higher taxes that further reduce income and output, continuously increasing the debt-to-GDP ratio. For the eurozone as a whole, public debt is over 95 percent of GDP, much higher than the artificial 60 percent of the Maastricht Treaty and the level Germany insists be followed.

As the bigger economies like France, Italy, and Spain are also under the grip of austerity, the entire continent would ultimately see government revenues collapsing. Worse, exports to neighbors are hurt by a reduction of demand, as has happened in Greece. Lower wages and prices in one member country engenders competitive deflation and compounds the problem, as each country tries to gain advantage in order to promote growth through exports. What is most remarkable is that the European Union's largest exporter—that is, Germany—does not yet appear to recognize that its insistence on fiscal austerity for all of its neighbors and the promotion of a beggar-thy-neighbor, export-led strategy can neither last very long nor will be accepted by those charged with running the global economy. Furthermore, stagnant external demand will take a toll in Germany.

Many, including ourselves, have long suggested that the union of growth convergence, which is the theme of our conference, requires a mechanism for redirecting demand to the trade-deficit nations—for example, by having surplus nations spend euros on direct investment. Such a mechanism could be set up quickly under the aegis of the European Investment Bank. Effective incentives to recycle current account surpluses via foreign direct investment, equity flows, foreign aid, or imports could be easily crafted.

But these suggestions have fallen on deaf ears in Berlin and in Brussels. As we will show tomorrow, the strategy of internal devaluation that has achieved a [nearly] 30 percent reduction in real wages, surpassing the troika's initial target of 15 percent, has made Greece very competitive, but it has failed to increase exports significantly. Instead, it has proved to be detrimental to living standards and domestic consumption, the most important stabilizing driver of the economy. In Greece, the path of exports, as the evidence shows, was unstable before the crisis, and it's still unstable now despite the increase in tourism, [which is] not sufficient to offset the precipitous decline of private and public consumption and investment.

To be sure, exports are important; but domestic demand is crucial. Even China, the largest export-oriented economy, has begun reorienting its economy toward increasing and stabilizing its domestic demand, and this should be the emphasis for Greece and the other countries of the European South. The government has mounted a considerable public relations campaign celebrating the achievement of a primary budget surplus last year and a small growth rate announced last Friday to engender optimism that the country has finally turned the corner.

That optimism, however, as we will show, is not well founded. Despite encouraging signs of an incipient economic recovery, Greece remains mired in the deepest of economic depressions and is now burdened by a mountain of debt, with its strategic options limited. Reducing the stubbornly high unemployment and reversing the declining fortunes of households are urgent public policy priorities. Economic growth and increased domestic demand will not come about from private sector expenditures while the household sector continues tightening its belt. The business sector is without viable options for financing investment and the banking sector is still shaky, with a large stock of nonperforming loans. Despite the millions of tourists visiting the country, tourism will not save Greece. High unemployment and declining production have pushed Greece into deflation territory, [and it's] unclear if it will be a relatively short-term phenomenon.

The business-as-usual approach must come to an end. The Southern European nations, and especially Greece, need a pro-growth and employment policy. As we will show tomorrow, there are ways that these goals can be achieved.

All of what I have said up till now is drawn from the work of Hyman Minsky and Wynne Godley, both distinguished scholars at the Levy Institute for many years. Hyman Minsky documented the importance of not being fooled by the illusion of small government, while Wynne Godley, who was the architect of macroeconomic models, provided the means to simulate the results of bad and good policy with peerless accuracy. This conference is, in a way, a tribute to their contributions. Thank you again very much for coming, and enjoy the conference.

Keynote Speaker

YANNIS DRAGASAKIS

MP (SYRIZA) and Vice President of the Hellenic Parliament



I'm glad I have the opportunity to be with you today. I would like to thank the Levy Institute and Mr. Papadimitriou personally for their invitation. I was informed about what has been said so far in the conference. I think that many things have been explored and many things have been financially analyzed. And I think what I have to do is, most probably, taking into consideration these analyses, to try to add a political dimension to what is going to happen in the future. I was also informed that we could have a Q&A session, which is something I prefer since I represent a political party and maybe there are questions for

clarification—and we politicians have to listen more than talk. However, I think we could split the time available into two parts: first, I would like to say a couple of words, and then we are going to have a Q&A session.

I would like to start with something mentioned in the program of this conference: “Europe at the Crossroads.” I would like to add that the whole world is at an historic crossroads, especially here in Greece. We see wars in our neighborhood, civil wars, huge social problems—unemployment being the most important one—and ecological problems coming from the past but also from the future because of climate change, and I think that all debates end with saying that something has to change in the course of the world, in the course of Europe, in the course of every European country.

I wouldn't like to offer a code or a ready-made recipe; I would like to say that among the things that have to be done are a few, but critical, fundamental changes. For example, politics has to come to the foreground against financial Darwinism, religious fanaticism, and nationalistic blindness. Another change: the rules of democracy should be over and above the rules of money, profits, and the markets. And the consensus of the people has to come to the front, and substitute for the oligarchies, even in the case [where] these oligarchies are formally elected in democratic processes. This is the only way to create the political framework aligned for implementing financial solutions according to the needs of the many.

To achieve these fundamental changes, the peoples have to come to the foreground. Social movements have to become stronger. The role of citizens has to be reinforced, and the left has to overcome its fragmentation and the dogmas of the past and become the leading principal in this struggle for the changes necessary in our times.

The SYRIZA party has identified this. We have taken positive steps, and most probably these have led us to this position, of becoming the preferred party of the majority of Greeks. SYRIZA is already a reference point in Europe, and it seems that SYRIZA is not going to remain alone in this difficult but hopeful course. It seems that there are developments in many other countries of the European South, and not only there. And despite the fact that these procedures are just in the first stage, they indicate that there is going to be a further direction—they confirm a strategy. We have to come out of the crisis not by introversion; we have to become open to the world, to the movements and the peoples faced with similar problems. And in our case, I would say, it's the European peoples that have to fight for this change—in the European South, but not only there.

This historic nature of these developments is something that holds true in Greece. This is the fourth major bankruptcy of the Greek state [since] its founding. However, the debt problem is a symptom of deeper causes. The crisis has brought up the problems of Greek capitalism, and the so-called Greek kleptocracy and the pathogenesis of decades or centuries. The Memoranda were not the right recipe for [curing] these diseases. They have exacerbated the situation, and now the Greek society is faced with crime and destruction that is warlike. It's as if we were in war—as if we were in a war zone.

After this brief introduction, I would like to touch upon three problems: First, the Memoranda have to be abolished. Why? We shouldn't engage in a discussion of an extension of the Memoranda or even their modification.

Second: reforms. What do we mean by reforms? What has been the result of the reforms in Greece so far, and what kind of reforms do we need? How are we going to implement them?

Thirdly, I'm going to raise the issue of negotiation, which has to happen—real negotiations with the EU. As regards the Memoranda of Understanding, of course there are some signs of recovery. If they were confirmed, that would be welcome. But we shouldn't deceive ourselves. Even if the recession is over, the end of recession doesn't mean the end of the crisis. I think you have analyzed this extensively. Mainly, it doesn't even mean a reduction in unemployment. According to estimations, to say that the crisis is over—that is to say, that the GDP of the country is back to 2009 levels—people say that it will take many years, and anyway, this is not going to happen before 2025 or 2026.

However, the Memoranda have to be abolished, not only because of their financial and social results. There are certain aspects that haven't been discussed extensively; however, they're important as regards international developments as well.

First of all, these Memoranda were imposed without a social dialogue, with no public debate about alternative policies, which might be there, I don't know. Even today, those who were responsible for the Memoranda accept that, yes, there were alternatives back then. The Memoranda have never achieved any social legitimacy and their acceptance was a result of blackmail: you either vote for the Memorandum, or you go bankrupt. Of course, this is not a justification for the MPs that voted in favor. So the need to abolish the Memoranda is based not only on the bad results, but also on the fundamental principles of democracy, people's sovereignty, and the very principles of the European Union—unless these principles are no longer of interest.

Secondly, the Memoranda have to be abolished because, right from the start, or even later, there was never an estimation of the social consequences of the measures implemented. What was also not ensured was a "fair" distribution of the burden. I would like to read a declaration or part of something [Jean-Claude] Juncker said in front of the European Parliament before voting. Mr. Juncker said, "I propose that

all financial support programs in the future should be evaluated not only on their financial viability, but also on their social consequences. The social consequences of structural reforms have to be publicly discussed.” And, finally, he said, “It is incompatible with the social market economy in a crisis to have rentiers and speculators becoming richer, whereas at the same time people with a pension cannot pay for their daily needs.” Is it still true? Is it true for the future? And how about the past?

Thirdly, there is a debate, and there are many leaks and whisperings, about the exact role of the troika and the Greek political leadership as regards various financial centers. Some people say that it was not done by the troika, it was [requested] by the Greek government; or the other way around; or, “This was not our intention, this happened by accident, and some mistakes were made.” So what’s interesting is that we have active participation of international agents such as [German Finance Minister Wolfgang] Schäuble, who said many bad things about the national financial Greek elites; or [Timothy] Geithner, the former [treasury secretary] of the US, who spoke about the role of the Europeans, or some of the Europeans, that handle the Greek issue.

Anyway, I have to say that an impression was created that finally what we call the MOU [Memorandum of Understanding] was not just a financial program; it was something beyond a financial program. It was like a weapon of mass destruction to destroy growth and rights. It was a form of collective punishment against the Greek people. So it is obvious that the Memoranda have to be abolished, and we have to explore the terms and conditions under which they were imposed. We have to investigate the deficits. What was the reason for these deficits? Why weapons purchases, and what was the role of certain people in army procurements, for example? We have to investigate the reasons for the increase of the debt through time. This was also a commitment by [then prime minister Antonis] Samaras before the elections; however, he didn’t do anything about it afterwards. So it’s even EU regulations that call for this type of investigation, and there is also a similar proposal for Greece to investigate the proposals of [Cephas] Lumina in his report for the UN about financial rights in Greece.

Some quarters maybe are afraid that their liability will be uncovered. Instead of fighting against the problems, they fight against SYRIZA, not only on the logical level—that would be okay. They just spread fear—they proceed to fearmongering against our party. However, our party is a hope for Greeks. Elections, or premature elections, [are] the right democratic way out. So I have to say that the proposal made by [Alexis] Tsipris, our president, in his meeting with the president of the republic is an answer to this fearmongering, because it’s a full, comprehensive proposal as regards elections and the Memorandum.

For us, for the SYRIZA party, what is important is not just to abolish the Memoranda; we want to substitute for them a comprehensive plan of recovery of our society and our democracy, of transforming the state and the economy [into] a socially fair and ecologically viable model. Going back to the pre-crisis situation is not something to wish for, and anyway, it’s not feasible. SYRIZA was referring to the pathogenesis of the system even before the Memoranda. Our work as regards our party program started in 2008, sometime before the collapse of Lehman Brothers. We realized that the oncoming crisis would be very strong, with a long duration, and we estimated—quite correctly—that the left had to intervene not only in the trade union movement and not only in defense. We have to intervene as a vehicle of an alternative policy [as well].

The SYRIZA party’s program is not just a program against the Memoranda, and it is not just a program against austerity. It’s a program that goes further, in the sense that it has as its objective not just to achieve growth, but also to achieve a new development model for Greece—a new productive model for

our country—because the crisis we are experiencing is not just a management crisis. It is a crisis of the prevailing model.

I [don't want] to get into details as regards the program of our party. Let me just mention our three major priorities: First priority: to deal with the social problem, starting with the problems of extreme poverty and unemployment. Our president presented a package of specific proposals that can be implemented directly as regards this program. These proposals, I have to say, were seen in a positive light, and not just by our friends.

Our second priority is the institutional reformation of the country and our society with radical changes, which I'm going to mention right away.

Third priority: last but not least, the production model of our country. What do we produce? How and for whom? This problem is not something new; it's a timeless problem. However, for many reasons, after the war we managed to survive on shipping, tourism, construction, and a little bit of the rest. However, this model is no longer viable. Moreover, there are technological and other developments that have to be taken into consideration. Therefore, we have to redesign the production map of our country and mainly upgrade our production basis.

Now let me come to the so-called "reforms." I would like to explain that I'm going to use this term. What has happened so far was not real reform; it was deregulation, a dismantling of the labor market and the state. And not everything in Greece has to be reformed. We have to create new institutions. Some things have to start from scratch and be fully redesigned, such as our taxation system. However, in the Greek and foreign press we read certain views. Some people try to give advice to the Greek people to be patient for a couple of years; or sometimes they make proposals to us, to our party as well, to go on with reforms. As regards being patient, I don't think that there is room for this for the Greek people. Patience means being equally responsible and guilty, because coming out of the crisis is not a matter of time; it's a matter of changing policies.

Now, what are the results of the reforms so far? Can we say anything about the labor market? Today, it's actually a jungle out there. What is the situation of the state? Do we have a functional state or is everything in chaos? We have to reopen the debate. What are the necessary reforms for the Greek society? We have to prioritize them and implement them.

A first reason for the failure of the reforms so far is, in my view, the wrong explanation for the crisis and its causes. For example, the central problem of the Greek state was not its size; it was its lack of credibility, low social effectiveness, and clientele relations. Of course, this is a very important problem, but it's not the only problem. We have unequal distribution of the burdens. State resources are used in favor of the strong and not the weak. Some practices are accepted practices that lead to stealing public wealth. Another problem is outside taxes, but also some internal factors corroding what is a public good.

Have things changed with the Memoranda? No, because the objective of the Memoranda was to reduce wages and not to improve the state. The state became more ineffective, more biased, more class-oriented, more unshielded to private interests, less rational. This is why we need reforms of another type.

SYRIZA had proposed a comprehensive program of real reforms covering the state, the political system, and society. By the term *real reforms* I mean transformations and radical breakthroughs that are required in the society. Those will start [with] and presuppose a government based on SYRIZA, and it's going to be actually reforms and changes that will aim at combating poverty and inequalities and corruption, transforming the state, tax justice, and combating the problem of unemployment on the basis of a new, productive model.

The second reason why the reforms have failed, I think, has been the wrong prioritization, and the fact that they were attempted from the outside and from top to bottom. This must become a lesson for the future, because even popular reforms must be the outcome of dialogue, and then they must be implemented in a manner that will inspire and involve the stakeholders themselves. On this basis and in this spirit I would like to say, in SYRIZA, we are ready and willing to discuss with other political forces and with scientific and social entities, but also international bodies, and to include in our program any reform and any international experience or good practice contributing to the achievement of the goals that I already mentioned, the goals of our program—that is, the needs of society.

I would like to mention briefly, very briefly, the main fields in which, in my view, such interventions must take place—either reforms or radical breakthroughs and modernizations. First of all: institutional reorganization of the state and the political system—emancipation of the state and the political system from interest mechanisms. And, of course, impunity has to be ended. It is funny, for those who have established the law on the responsibility of ministers ... to appear as those who want to abolish this law.

The second field is that of corruption and the shaping of new relations between politics and [the] economy. In a way, ... privileges and the dark journeys of money [will be brought to an end]. The landscape has to become new. There have to be new terms for entrepreneurship and new conditions for both private and public entrepreneurship.

The third field is the reorganization and upgrading of public administration. We have to put an end to client relations and the partisan armies that occupy the state every time that the government changes. We need to put an end to the parallel administration and parallel state structures. We have to establish reliability, credibility, meritocracy, accountability, and social control.

The fourth field is the creation of a new tax system that will be simple and just, based on a property register that will make no exceptions for [anyone]. If we do not create an objective and solid foundation proving the tax-paying ability of anyone, we will just be repairing an irreparable system.

The fifth field is the banks. Of course, this is a huge issue. Concerning the systemic banks, ownership and stakeholding for the big banks by the Financial Stability Fund allows us to start with exercising the right of the main stakeholder, but also taking into account the rights of other eventual stakeholders. But this is not enough. We need to create a parallel banking system, I would say, that would be flexible, and we must breach the gap and the absence of long-term lending, of borrowing, by creating a public development bank.... We must also create a network of small, flexible, special-purpose banks, either on a corporate or other basis. And we must strengthen forms, structures, and instruments—financial instruments and investment instruments—beyond the banking system.

The sixth field is the reconstruction of the social state, public education, and social security, because, unfortunately, a big part of those has been destroyed and therefore has to be reconstructed.

The seventh field is to restore labor rights—first of all, the right of collective bargaining and the shaping of effective forms of employment.

Field number eight: reforms and institutional amendments and changes that will upgrade the production basis, that will promote space planning and regional forms of development.

Nine: institutional and other changes that will promote ecological transformation and the creation of new, sustainable production and consumption models and behaviors.

And, finally, one more field should be the one where social institutions and social frameworks need to be established to support the social economy, an economy of solidarity, and also development of

individual and collective initiatives and other forms and institutions that will facilitate the involvement of people and local societies in the development choices, and development and growth in general.

I shall close with the third and last subject on which I would like to express a few thoughts.

We are often discussing public debt as if this were the only topic that needs to be discussed with our European partners. Well, debt, of course, is a significant issue. But there is a more general topic that has to do with our participation in the EU and eurozone. No country member of the eurozone, through national efforts and national domestic changes, can handle the crisis, not even big countries, and even more so countries like ours in their current condition. This is the result of the fact that critical policy tools such as the banks and the currency and so on are not national anymore, and they have been assigned to European institutions. Therefore, if we do not have pan-European policies, national margins, by definition, are limited.

Let me mention an example: if, for example, instead of tax cooperation in Europe there is tax competition? If tax havens can be tolerated in the heart of Europe, if other countries offer protection to tax evaders of other countries, then how can one treat radically and effectively tax evasion in any country, especially tax evasion by the rich? The same goes for the more general policy. If we do not tackle the fundamental economic asymmetry in the European Union between surplus and deficit countries; if there is no European policy for debt mutualization, relying on the European Central Bank; if addressing unemployment and poverty do not become the main objectives for the fiscal pact, equal to the objective of deficit and fiscal adjustments; if such changes do not take place in Europe, tackling problems in each country separately will only have limited results. That's why SYRIZA considers as part of its program and as part of its action its cooperation with other countries in Europe in order to change Europe. So we have a process, a very specific negotiation framework, which was announced at the international [trade] fair in Salonika.

I'm not going to enter into details about specific measures, but I wish to make a remark on a recently discussed issue regarding sustainability of the Greek debt. This has nothing to do with our political party's views; this has to do with a broad consensus in Greece and across the world that considers that our debt is not sustainable. We cannot adjust reality to the desires of some people because they are not ready to discuss the debt. There are some issues that have objective dimensions, and this is the case for the debt as well. I guess your conference has discussed documented propositions on this issue. The foundation for the negotiations can only be of mutual benefit. If we bypass these principles, there are going to be approaches [that are mutually disastrous], which is not desirable. And, of course, a united Europe is not feasible, is not possible, when some member-states cannot reproduce their societies and have sustainable involvement.

As the SYRIZA program mentioned in the June 2012 elections—because a lot has been said about the views of SYRIZA—so ever since 2012 we have been stating that the goal for SYRIZA is a new, honorable, and honest agreement with the peoples of the European Union that will allow Greece to apply a framework of radical breakthroughs and reforms to the directions that I mentioned before. That was our position back then, and it still remains the same. But in order to have such a sustainable new relationship, we must make sure that our debt is sustainable. We must make sure that servicing of the debt does not crash society. And we must also discuss the fiscal targets, because even if the debt is settled we cannot have such unrealistic targets, like those applied today that require fiscal surpluses even beyond 7 percent. We must also discuss the terms for financing of the economy, because the economy has lost its resources,

either because their sources were destroyed or were moved to other countries outside the European Union because there is no system to guarantee the deposits, to safeguard the deposits, throughout Europe. So I mean this is not just a bilateral relation between Greece, or between the SYRIZA government, and the rest of Europe; this is a question for all peoples across Europe. What kind of Europe do we want to have—a Europe of equal states, or a protectorate of destroyed societies? Nobody would be interested in such a Europe.

Can we succeed? Can we achieve all this? This, many people ask. If we view this as a side project, the answer is not certain. But if we view this as a project for and from society itself, and if SYRIZA becomes a government that fights with the people and not just for the people, I think we can succeed.

Thank you.

Q&A

Q: Thank you for this speech. One question and one remark: I attended the conference both yesterday and today, and as a European I am deeply sad about the course, the journey, of the European Union. I'm pro-European, but Europe, the way it is going, is not Monet's Europe, as was said yesterday. And today we said that Germany is strong-minded and stubborn, and is not going to make any compromises. On the other hand, there are countries such as Japan, which has now [experienced] 23 years of recession. Megan Greene, speaking yesterday, said that the eurozone will enter a 10-year recession. Therefore, the five years of the Greek recession are enough. This is the first question. And second, given that in a couple of years we may not have the euro anymore, has your plan included any alternative? I mean, perhaps some dependence on China, Russia, the US, Japan? If the euro stops existing, shall we go to dollars, for example?

YD: Thank you for the question. Well, of course, our times and the crisis we are going through are open to many possibilities. We may speak of more or less likely scenarios, but we cannot exclude anything. I must tell you that for many years now we have been discussing everything and we have been hearing everything and listening to everything, and we have concluded that the national and the left position is that we must fight within Europe. If Europe does not exist in the future, or if other facts take place, one must be ready to address them.

Perhaps our approach is different in terms of the wording of the question. Our view is that there's not one Europe currently, and there's not one Germany. Europe is the filter of conflict among different views, different ideas, and different prospects. When we stated in 2010, for the first time, that the solution for the debt is that the ECB buys sovereign bonds, we were considered to be irrational and beyond any reasonable context of discussion. And yesterday we heard [ECB President Mario] Draghi saying that this cannot be excluded. And eventually, they may do that in the ECB when Italy needs measures beyond those adopted today. When we stated that austerity will bring about recession not only in the South, but even in the core, in the heart of Europe, that sounded an exaggeration. And a few months ago, then Mr. Schäuble would exclude that.

Or let me state something more simple: when people were saying that the crisis is only in Greece, we were saying that the crisis is European for the reasons that I explained before; because, since policy tools are in Europe, anything that happens in a European country is European. And then Ireland and Portugal followed, and so on. So we perceive our participation in Europe not in static terms, but in dynamic terms, and we participate in this fight in Europe. We adopt views and positions vis-à-vis the conflicting views.

We are trying to subvert the correlations that put at risk the future of Europe and the future of the European peoples.

But, of course, we cannot predetermine the outcome. But, as I said before, we do have signs, we do have indications, of a confirmation stating that societies will not remain inactive. The argument that we have a very strong country and the leadership of this country cannot hear everything is a challenge, and we have challenged that because if we have a SYRIZA government in the future, and another government in Spain, for example, one could speak of such developments. I'm just raising these examples as illustrative examples, because we might see other countries in the future in the same conditions.

So, to summarize, concerns are well understood. We do share some of these concerns—the questions are real. But we consider the direction in which we have moved so far contains the facts that allow us to fight for a positive scenario, and a positive scenario would be to be able to shift Greece—shift Europe—in the direction of justice and solidarity.

Now, if a large country would exit the eurozone, that would be a new fact. But the question is, shall we invest in such possibilities and bet on those, or shall we work towards a direction which, as I said before, would be useful and beneficial for everyone? So we opt for the second way.

Q: You spoke of the 10 priorities that you have set in the SYRIZA party in case you become the governing party in this country. Have you assessed ... the time required for each one of these propositions, or for all of them?

YD: The 10 priorities are the 10 fields where there must be interventions of a very full nature, a very full character. Well, we discussed this from the very first moment, because those of us who are on the left, up until the crisis and also because of the dimensions of the political parties, at least my party—the coalition of the left was at around 2 or 3 percent—and since we were interested in the practical impact of what we were saying, mainly we were adopting a declaration speech, that we want a society of justice, we want respect for the environment. We were only making statements and declarations, and we did not have any pressure back then to go for applied policies. But when SYRIZA took off and gained such high percentages in the elections, and when we took over governing responsibilities, we were concerned [about] this time frame. When would that be feasible, or what can be done in these specific circumstances? This has been very productive and fruitful, and it is still fruitful because it is an ongoing effort. And I believe that the left also needs to resolve historical problems of the past, because there may be revolutionary conditions; but without any revolutionary conditions, how can you promote your ideas? The risk would be that you may forget the values of the left, or there is a risk that you may insist on your values in an emblematic manner without correlating ... them to the current needs. Thus, they would just remain wishful thinking.

So the outcome has been that, first, we need to make the values of the left—or the basic human values adopted by the left—we must turn them into applicable policies. So what does justice mean for Greece in 2015? How can this be expressed, in what priorities, what measures?

Second, in terms of the time frame, we had to plan our actions at least in three dimensions of time. That was more or less a slogan: what we will do in the first phase, the first months, and the first years. This is the triptych on which we have been working. We have set up teams on a SYRIZA level, and after shaping the general positions in each sector, then we shall proceed with government action plans to be able

to know what we shall do the first days, then the first months, then the first years. All propositions announced by Alexis Tsipris at the world fair [Thessaloniki International Trade Fair], we want them to become draft laws. We would like to table all those propositions as draft laws to the Parliament, even if they are rejected, because that will mean that we will have a stock of legal interventions to work with when we become the government. This is how we work on this.

Now, there are also issues such as the new production model. This is a 20-year affair if we want to transform the economy with ecological models and new production models; but from the very first day we must start doing something. We have “red” business loans, or other pending issues in different fields, and we must start with our planning. Because without planning, specific issues cannot be resolved.

It is also the institutions related to those plans, because now the political party may provide some guidelines, but in the future it should be the state or the society that should be mobilized through institutions. But [this is] not to give you the impression that SYRIZA has everything ready in the drawer. I’m just describing to you our intentions and directions, and they can be implemented in different ways and different times. But we do proceed. We’ve made progress.

Q: ... I wanted to comment on something concerning the European problem, because everybody keeps saying that it is the debt and slow reforms—that it is the accounting of things in the European framework. So I would like to ask you, do you agree with me? The problem of undergrowth—is it just accounting figures, or something more? Can we reach development through reforms in real education? ... Could our problem be the high rate of racism? Could undergrowth be due to the problem of sports, especially what we [have seen] recently in the football field, in the field of soccer? Because there are football clubs, a couple of them, that control the whole sport? So could it be a matter of culture on the broad level? Could it not just be a matter of accounting figures? Do you agree with me on the magic global stimulus, incentive? You must give incentives to people to do something, because throughout this period of the Memoranda, the bailout programs, I have not seen you discussing the ideas of young people, of university students—just confrontations on the Memoranda, the debt, the reforms. So do you agree with me that incentives are required? Do you agree that real incentives must be provided if we really want to do something?

YD: I thank you, but since you are a student, you can answer all these questions on your own, by yourself, through studying, through learning. Because our generation, in a way, needs to learn. You see, our generation is not very proud of everything that has happened during this generation; and the new, young generation is the first one that will live in worse conditions. So our role is not the role of a professor or a teacher to its students; it is the bridge with the new generation, with the young generation.

But since you’re asking, let me say, there are no figures—there are no numbers. There might be numbers behind relations that concern our lives. Debt, for example, especially accumulated debt, is consumed capital, and consumed funds that somebody has to pay out. It is overpriced and it is overspending—it is kickbacks, lost money, tax evasion, money that escaped abroad. So behind the debt figure there is a major problem of distribution and redistribution, allocation and reallocation. If we are called [on] to pay this old debt, there’s no future. We cannot at the same time serve the debt of the past and at the same time finance growth. So ... we should see what is hidden behind figures.

The second remark I could make is that you are raising the subject of values—the value framework and the incentives. What should the incentive be? Should the incentive be profit? Because this has led us to Darwinism and the jungle, and whoever manages to eat the other is considered to be the winner. Well, I believe we have a past here that we need to deal with, one that is called *neoliberalism*. It is not just an accidental movement, and it should not be underestimated. It has done great work, and it has shaped consciousness on the basis of these ideas—according to which, freedom is everything, and not justice. We do want freedom, but freedom without justice is freedom in exploitation.

For example, they speak of competition as the supreme value. But competition is done also through partnerships, and not just through wars. Or they have fostered the idea of individualism, that ... we do not need common good, or common ways—each person can do it on his own. And consumerism has become a religion. You spoke of incentives. Well, owning two cars or three cars or different consumption goods as measures of culture or civilization—among other things that you mentioned, this is what I got, and I think that this stresses the fact that we should not view growth only in strict monetary economic terms, but also in value terms and political terms. And especially in Greece, this is a most relevant topic.

You mentioned a term that is not mine, but it is a very descriptive term. We do not have exactly capitalism in Greece; we have a special type of this that is plutocratic. This is what Marx would call [production forms of] surplus value. These are forms of wealth acquisition through stealing—stealing taxes, stealing public property, appropriation of the coastline or forests. There are such regional phenomena everywhere, but in our country these are the central paths that shape the dominant system that we have today.

I wish you luck in your success in your studies and in your fights.

Q: [My] dear friend Yannis, a while ago, was in our country—you were on the same panel—and he heard said that the new social democracy had collapsed because the structural changes performed were only superficial, and when the neoliberal narrative became leadership, this was all carried apart. And in the past, you [SYRIZA] were being accused of being terrorists and dangerous for the course of the country, and so on. This argument, of course, collapsed like a paper towel when your percentages went up, and now you are claiming the power. So the style of intervention has changed, and there are views stating that your politics will, of course, be better administered compared to the past, and therefore SYRIZA would become a systemic political party.

So I'm asking you about your vision. The Greek case, or the European case—where is it heading? Does this still exist, or are you pulling this apart?

YD: Well, since you said what they were saying about us, this is what they used to say in the morning. In the morning, we are terrorists. In the afternoon, we are incorporated into the system. In the evening, they are complaining because we are not consenting with them. These are just forms of confrontation when confrontation cannot take place in the field of ideas and programs. I'm pointing this out because we, SYRIZA, would never claim that we are infallible. On the contrary, we say that this program is an ongoing process, and we are always open to ideas.

But in Greece we do have a problem in this field of dialogue. We have always had this problem. Now it has become more acute. What you're raising is a major issue, a major topic, that concerns the whole of society, of course, because everybody is currently asking about the vision; but this is most relevant to the

left. Well, I could not give you an answer because answers to such questions are actually given in practice, and sometimes it is only afterwards, *ex post*, that one realizes what the vision has been.

So what was the vision that led to the rebellion in the technical university? One could say that this was bread, education, and freedom. But no, that was a more general need for emancipation and protection of dignity, which was violated back then. And sometimes when we read history, we see a historical moment that is not just for the left but for the whole Greek people, which was the moment of the Greek resistance. And we wonder, what made people put their lives at risk in order to protect their life and their dignity? So I mean that, perhaps, in our times the vision may be not crystallized—it may not have the crystal-clear shape and form it used to have in other times.

We joined the left, we went onboard ... a train, without wondering who the driver was or what the itinerary would be. We did that. The times were different, perhaps because of the bankruptcy of the older models. And these are the times that will display their own visions, but this can only be done through participation in common affairs, because we are all interested in survival, changes in the state and society, protection of dignity, and everything that I tried to say before.

Q: I would like to confirm that this conference was very interesting, touching upon many issues. There were criticisms and emotional touches; issues of finance and the labor market were touched upon. What was missing—and I think that it is missing in the debate—is the issue of production. And since you mentioned production when you mentioned your program, I would like to ask the following question: is it feasible in the future to have a discussion in the EU about a European union on production issues? This could be a complement to the European architecture the way it is now.

YD: Thank you very much indeed. This need is deeply felt, and it's not just production. We also have the issue of industry and industrial policy, especially from the southern countries. France is concerned as well.

The problem, however, is that debating is not enough. The existing policies and the architecture of the European Union are not favorable to a redistribution of labor. For example, in the case of industry, some countries only offer tourism services or shipping services. This country should also form a production basis. So I think that this issue should become a claim. That is, we have to start by saying that this Europe, with its existing distribution of labor and some importing and exporting countries, surplus countries and deficit countries—and these two do not communicate—this type of Europe has no future. And one can prove it in financial terms as well.

The debate that is not happening is about what Keynes proposed after the Second World War, a type of a clearing union to recycle surpluses. If this does not happen, then we are going to have a Europe with internal [asymmetries], and I don't think that this Europe will be able to survive.

However, there's always this political dilemma: somebody could say, "We can do nothing in Europe—let's get out." Some other place: "Okay, we can survive and do whatever we can—only tourism, for example." We are trying to find something in the middle, which is a program of claims. Claims will bring us in touch with other peoples with similar claims; that is, we're going to have alliances. This is one pole.

Austerity is the one pole; surplus and recycling these situations is the other pole. Is the pole claiming an exit from austerity and unemployment? So, yes, there is this road. It is a debate, but we could also

do something about it—take action and form alliances. It is not just an academic discussion; of course, this type of academic discussion is also [worthy].

However, there are particularities in the case of Greece. That is, let's say that we do have a plan for production reform. It seems, however, that we are going to be led to a monoculture of tourism. It is our natural competitive advantage. Yes, that's the competitive advantage of Greece—this is our competitive edge. However, we could destroy it if we develop tourism without a plan and protection of the environment. Or we shouldn't only cultivate, so to say, tourism, because we are going to have this export-dependence model repeated—we are going to repeat the model that led to this crisis. So it's very important to start planning.

We have worked on this. Many people have worked on this—scholars, and I think that our universities have a more active role to play in the future. So it seems that there are sectors or clusters of activities where Greece has potential; for example, foodstuffs, energy, selected industrial activities, knowledge and technology around energy. So these sectors can be successful, and I think that there are things happening in a haphazard way and without having public support or a public plan. There are projects in the national technical university. So yes, indeed, this issue is real, and we have to be more aggressive, not just debating. We have to plan things, starting with what we have and what we can do....

Sessions

SESSION 1

European Monetary Policy and Market Flexibility



Nikos Chrysoloras, Emiliios Avgouleas, Lex Hoogduin, Mario Tonveronachi

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AVGOULEAS approached the question of the free movement of capital from the standpoint of the internal eurozone market. Specifically, he asked, “How has the internal market interacted with the monetary union and monetary policy? And in what ways have capital movements played a key role in causing structural weaknesses?” He noted that the free movement of capital has never been clearly defined despite the fact that it is the cornerstone of the internal market. In practice, capital movements are usually defined in reference to the liberalization directive of 1988, which more or less incorporates the International Monetary Fund’s (IMF) definition of free capital movement (i.e., financial flows between financial institutions, corporations, or individuals). However, there are a number of restrictions on capital movements recognized by European law (e.g., restriction of flows during a financial crisis, to prevent money laundering, and so on).

Avgouleas described the European Union's (EU) stance on the freedom of capital as "maximalistic," covering both long-term and short-term capital flows. He observed that the prudential case for the restriction of capital flows is rather limited, and will become even more limited in the future because bank supervision and resolution will be under a single supervisory mechanism operated by the European Central Bank (ECB). He stated that if a country wanted to invoke the prudential restriction to stop capital flight, such a move would occur after a financial instability event had already occurred and would thus be too late. Avgouleas also discussed three flawed assumptions in the current policy regime: (1) short-term capital flows are as beneficial as long-term capital flows, (2) a currency union will not experience "runs" on member-states, and (3) there can be no balance-of-payments crisis in the sense of those that have occurred between a fixed exchange rate system within the Economic and Monetary Union (EMU), and, as a result, exchange rate shocks have disappeared.

Next, after reviewing the events that led to the current eurozone crisis, Avgouleas asked what a member-state could do to protect itself in the absence of stabilization mechanisms. Turning to some of the restrictions on short-term capital flows permitted under European law, he noted that all fundamental freedoms are subject to a general exemption that is referred to as "the general interest." A restriction on short-term capital flows based on a general interest exemption must meet the following criteria: (1) a country must objectively face fiscal crisis due to macroeconomic shock (e.g., entering the excessive budget deficit procedure under the European Stability and Growth Pact, or SGP); (2) the measures must be provisional, and thus proportionate; and (3) the restrictions should not extend to either commercial or trade payments, to foreign direct investment commitments, or to any other prior payments.

Avgouleas stated that widening the prudential carve-out rule is not feasible for several reasons. For example, he argued that a carve-out would apply the brakes to outflows resulting from a panic but that it would be ineffective. Restricting capital flows will not, he argued, counter an economic shock, even if the restrictions meet all of the criteria listed. He suggested that what is needed is an EMU treasury and limited debt mutualization. Debt mutualization would involve some countries paying more than others. An internal payments mechanism could redress this by having high-risk, deficit countries assign their share of the ECB's profit to the low-risk, surplus countries to offset the higher interest rate paid for their public borrowing. The benefits of this approach include nondefaultable bonds, a lower interest rate on these same bonds, and the fact that creditors will see a lower risk of default on mutually issued bonds.

At the very least, Avgouleas argued, the benefits of bail-ins may be exaggerated. In his view, bail-ins will increase the cost of bank refinance. But if that's the case, and if member-states have no real confidence in the effectiveness of the pan-European resolution mechanisms, the next step is subsidization. Subsidization, however, like capital restrictions, is yet another threat to the coherence and orderly functioning of the internal market.

Avgouleas concluded that a single member-state might independently restrict short-term capital flows, a move that is probably legal and likely to create fragmentation in the internal market. If nothing is done, the currency union will face a slow, drawn-out process of internal market disintegration. The solution is to mutualize member-states' debt and establish, if not a common monetary union treasury, a set of fiscal governance mechanisms that would *amount to* a single monetary union treasury.

HOOGDUIN focused his remarks on the ECB's mandate, performance, and possible challenges in the future. He began with an overview of the bank's objectives as defined in the Maastricht Treaty. Its primary objective is to maintain price stability and to support the economic policies of the EU. However, the

treaty does not define “price stability” explicitly. Today, price stability is defined as an increase in a harmonized index of consumer prices that is close to but below 2 percent in the medium term. Hoogduin noted that the ECB intends this definition to be symmetrical (i.e., avoiding both inflation and deflation). Under the treaty, participating EMU countries are required to meet the convergence criteria on a sustainable basis. The treaty also stipulates that the euro area is a market economy. The ECB’s involvement in financial markets, and markets in general, is based on the philosophy that markets function well and interference should be minimal. However, in the short or medium term, the ECB believes it can positively influence real variables affected by market friction. Within this framework, structural reforms are seen as a way to improve welfare and the transmission of monetary policy. The ECB’s primary policy instrument is the short-term interest rate; specifically, the overnight interest rate.

Turning to the performance of the ECB, Hoogduin described the Maastricht/ECB framework as being in a state of disarray. According to his diagnosis, there is now a “nonregime.” Two things caused the framework to deteriorate: noncompliance with the convergence criteria and a strong asymmetric shock resulting from the worldwide financial crisis. The shock caused divergence among the euro-area economies, thus putting the ECB in the position of acting as a common central bank in an environment in which the conditions necessary to do so were no longer met. In this sense, the ECB itself was a victim of the crisis.

In recent years, the ECB’s operational framework has changed to include a zero or below-zero interest rate. Monetary policy has become ineffective, and Europe now finds itself in a “no-flation” situation, with deflation in some countries. Therefore, the ECB is not meeting its primary objective. There is also what Hoogduin referred to as “a spread problem” (i.e., a wide range of inflation rates). He noted that the ECB cannot do anything to raise inflation in individual countries; it can only try to raise the average rate of inflation.

Hoogduin observed that there are no simple solutions. The use of nonstandard measures and the extension of standard measures have led the ECB to depart from its original design. The ECB might engage in quantitative easing (QE), but this is unlikely to work if the goal is to create inflation. QE could lead to the formation of bubbles in the financial sector or lead to market distortions. Such measures also change the incentives for market behavior or financial institutions. Hoogduin noted that financial analysts are currently very interested in when and if Mario Draghi will start buying assets, and in which assets will be most profitable.

There is also the question of whether the ECB’s policies strengthen the potential for growth or weaken it. Some argue that monetary policy has become too focused on the financial sector: it has become asymmetric, meaning that when financial markets are strong, monetary policy does little, but the moment that financial markets get into trouble, there is a rapid reduction in interest rates. This leads to high returns on financial assets (so long as the process continues) but makes investing in physical assets relatively less attractive. Finally, these policies may increase the inequality of the wealth distribution.

As an alternative to its current policies, Hoogduin suggested that the ECB, rather than implementing nonstandard policies, could announce that it cannot deliver price stability until the euro’s underlying problems have been dealt with. One could also argue that the euro area as a whole requires a renewed convergence process and a redefinition of price stability, leaving out countries with lower inflation since low inflation may be the result of restructuring to improve competitiveness. There is also the option of applying a policy of maximum flexibility within the SGP, and relaxing the rules. Hoogduin expressed his

understanding for resistance to debt reduction and debt options in the core countries. Finally, he noted that the role of wage policies (i.e., promoting higher nominal wages in the core countries) has received very little attention until recently.

Longer term, Hoogduin argued for a redefinition of the monetary policy framework. One issue that should seriously be considered is that the definition of inflation is too narrow. We have not, said Hoogduin, made sufficient distinction between different types of capital: productive capital, financial assets, and durable consumption assets. Housing should be seen as a durable consumption asset and included in the consumer price index (CPI). Hoogduin argued that if housing had been included in the CPI, inflation and interest rates would have been higher, and we might have avoided the last boom. There is also a clear need to extend macroprudential policies.

The question remains as to how the ECB will move forward. There was a well-defined framework for monetary policy—and, more generally, for financial, budgetary, and economic policy—before the crisis. Today, that framework lies in tatters. Hoogduin concluded that Europe is currently operating under an ad hoc regime. It remains unclear how and where to exit this regime.

TONVERONACHI noted that it is now a widely held view that the design of the euro area is incomplete because it lacks political union. However, political unification seems more remote today than when the Maastricht Treaty was signed in 1992. He observed that the current crisis has produced both fragmentation in the economy and financial markets, and political fragmentation in the euro area.

The design of the euro area includes two types of inconsistencies. First, the ECB is modeled as if it serves a federal state, when it actually serves a nonfederal coalition of states. Second, there is the goal of creating a single monetary and financial market, but no common set of risk-free assets.

The ECB is the only central bank in the developed world that relies only on banks to manage liquidity. This means that it leaves the private banking system to determine the size of its balance sheet net of bank deposits at the central bank. Thus, after the increase in the ECB's balance sheets in 2012, banks then decided autonomously how they would redeposit this money at the central bank, how much to use, and when and how much to repay the central bank. Despite a charter that allows the ECB to use open market operations in theory, in reality there are political and ideological problems.

Turning to the central focus of his remarks, Tonveronachi noted that the euro area does not have a single financial market. In place of such a market Europe experienced a degree of convergence before the crisis, but that convergence is fragile. A single financial market requires a single, unique user; a single issuer; or risk-free assets. Risk-free assets common to all financial intermediaries, not only banks, are necessary for efficient market pricing. Absent a single-risk issuer, local financial conditions remain linked to local sovereigns. A banking union alone, he observed, cannot create a single financial market.

Tonveronachi next offered a proposal that could be implemented within the current political framework with no treaty changes or alterations to the ECB's charter. Under his proposal, the ECB would issue "debt certificates" covering the entire maturity spectrum. The ECB would balance these issues with the secondary-market acquisition of sovereign bonds of the E variety in proportion to each country's contribution to the ECB's capital. After a certain point, the ECB would stop accepting sovereign bonds for its refinancing operations and use only its own debt certificates instead. This would encourage financial intermediaries to exchange sovereign bonds held for liquidity. To limit the role of the debt certificates'

liquidity function to inside the euro area, only financial operators incorporated as firms in the euro area could hold and trade them. Debt certificates would serve as a benchmark for liquidity management in the euro area, not for investment purposes. Thus, a secondary market for these certificates would be created, and the ECB could use this secondary market for its open market operations. If implemented, and if the ECB were able to contain inflation, the proposal would create certificates that would be free of credit risk.

Tonveronachi argued that the proposal complies with current treaties because the acquisition of bonds in secondary markets is currently permitted. In addition, acquiring these bonds for liquidity management would comply with the spirit of the Maastricht Treaty because it is necessary for the functioning of the single financial market. Further, the balance sheet of the ECB currently shows the number of these debt certificate issued as zero. They are described as part of a structural intervention for open market operations, but they have never been used. In the treaties and in the charter of the ECB, there are no limits on the amount or type of certificates that the central bank can issue. Thus, there is no prohibition against creating debt certificates.

The last problem is political, said Tonveronachi. Some may object to the ECB holding sovereign debt on its balance sheet. The concern is that, if there were a debt restructuring, or failure to repay debt in some cases, the ECB would lose capital. Tonveronachi noted that a central bank that issues paper money has a capital position that is always positive—that is, a central bank is by definition in a Minsky hedge position and its capital position is always positive.

SESSION 2

How to Build a Stable European Financial System: The Central Banker's View



Marek Belka, Viktoria Dendrinou, Patrick Honohan, Lubomír Lízal

MODERATOR:

VIKTORIA DENDRINO

The Wall Street Journal

PATRICK HONOHAN

Central Bank of Ireland

MAREK BELKA

National Bank of Poland

LUBOMÍR LÍZAL

Czech National Bank

HONOHAN addressed the issue of financial engineering, monetary policy initiatives, and the interplay between the two. Financial engineering and monetary policy are recurring topics in discussions of the euro-area crisis. Debt, he observed, is at the heart of all of these crises. It is therefore natural that we should think about monetary policy and financial engineering as potential solutions. Debt is a central issue in Europe for two reasons: official indebtedness has become very high, especially after the crisis; and debt ratios are falling slowly because of a low nominal GDP trend, real growth, and inflation.

In terms of financial engineering, there has been a major initiative in leveraging investments by European Union (EU) creditor countries into a new fund, the European Stability Mechanism (ESM), which has produced very substantial loans to stressed sovereigns, including Greece, Ireland, and others. In addition, Honohan noted that today the European Central Bank (ECB) has negative nominal interest rates.

Honohan stressed that a number of actions have been taken that would have been considered radical a short while ago, including such things as purchases by the ECB of high-yield assets, asset-backed securities, bundles of SME (small and medium enterprise) loans, and residential mortgages. Further, the ECB is lending to banks on a long-term secure basis but at a four-year maturity—a move that would have been considered extraordinary before the crisis.

Broadly speaking, the solution for the debt problem has been to make more loans, Honohan noted. But, he asked, is that “the best form of financial engineering to solve an overindebtedness problem? And, would it not be sensible to link repayments to some form of alternative risk sharing?” For example, bank bonds could be converted to equity or canceled in the event of a bank nearing a situation of insolvency. There is also the idea that a multilateral entity like the ESM investing in bank equity could change the risk structure. Central bank purchases of a targeted quantity of sovereign debt are another idea currently on the table. There is also European Commission President Jean-Claude Juncker’s recent collateralized debt obligation (CDO) proposal, to leverage a certain amount of public sector injections to achieve an increase in infrastructure finance.

Honohan argued that while the ECB has been criticized, monetary policy clearly has a role to play. Inflation remains below target. Thus, future action cannot be through interest rates but must occur using the balance sheet. He stressed that the size of the balance sheet (i.e., the amount of liquidity in the system) and the composition of the balance sheet both matter. To oversimplify, he suggested that there are two course of action: either acquire long-term assets, or acquire risky assets.

This leads to the question of how financial markets will be affected if “bits of credit risk and bits of term” are removed from the market. This is an important consideration with regard to quantitative easing. For example, he asked, if the ECB buys bonds, in which countries would it have to buy to have an impact? Some argue that it does not matter—all purchases provide liquidity to the market. Honohan disagrees with this assessment and sees markets as segmented. It is, in his opinion, important to consider what is being purchased and not simply how much.

Turning to other types of financial engineering initiatives, Honohan described financial engineering as a practice that seeks to bundle or unbundle risks in order to transfer or enable the transfer of risks to those best placed to absorb them. Honohan described two examples of risk-sharing plans. The problem, he noted, is how such plans are received by policymakers in different parts of the euro area. The envisioned benefits are seen as being skewed toward certain countries—and in fact, he said, the benefits probably *are* skewed. There are also clear moral hazard problems. And finally, the Maastricht Treaty prescribes actions that would turn the euro area into a transfer union.

In closing, Honohan observed that the obstacles to greater use of financial engineering include such things as contract credibility issues. If contracts are not honored, financial engineering is useless. He also noted the absence of sufficiently flexible institutional legal structures to allow these types of financial engineering schemes to be fully realized. And, finally, there are trust issues, and trust issues are about politics.

BELKA noted that his perspective on the euro crisis reflects the experience of Poland, a non-euro EU country. He focused his remarks on why some countries in the European Union choose not to join the eurozone, even when, as in the case of Poland, they comply with the Maastricht criteria. He observed that many countries outside the common currency have formal independence but limited autonomy because of their strong economic ties to the euro area. Such countries set their own interest rates and use

exchange rate policy, at least in theory, independently. However, in practice, financial globalization and general economic interdependence limit their autonomy.

Preserving monetary policy independence is part of the argument for staying outside the euro. However, if, like Poland, a country has a positive interest rate differential compared to its euro-area neighbors, it is likely to experience large inflows and outflows of capital. Belka noted that many economists regard the idea that individual countries can retain any reasonable degree of monetary autonomy as illusory. However, he added, what should not work in theory, sometimes works in practice.

Belka suggested that non-euro EU countries are here to stay because they learned from the crisis. These countries have limited independence: their economic ties with the euro area are extremely strong. For example, 75 percent of Poland's exports go to the EU, 40 percent go to the euro area, and 25 percent go to Germany. Poland has large inflows of foreign direct investment, approximately 85 percent originating in Europe. More than half of the country's banking sector is owned by banks domiciled in euro-area countries. Further, financial globalization goes beyond European integration. To this point, Belka observed that US monetary policy basically shapes what happens in credit spreads and risk premiums globally. The challenge, then, is maintaining price and financial stability, continuing real convergence to the euro area, and persuading large, advanced economies to take into account the spillover effects of their policies. Belka next summarized some of the actions taken by Poland to meet these challenges in recent years.

He explained that a country such as Poland can pursue macroeconomic policies to prevent monetary policy from being destabilized by unsound fiscal policy. Active macroprudential policy is also an important element. Belka noted the need for enhanced international liquidity supports. In the case of Poland, he said, "we are banging [on] the door of the ECB" in hopes of establishing a swap line between the euro and Poland's currency.

As mentioned earlier, Poland has seen substantial capital inflows, which have lately been mitigated. The inflows are largely due to the interest rate disparity, which makes it attractive to invest in Polish treasury bonds. Poland is a "catching-up" country, with relatively high growth dynamics. The problem is how to reconcile this with exchange rate stability, or at least limited exchange rate volatility. The euro-to-zloty exchange rate has been volatile in the past; however, this volatility has been reduced in recent years, partly as a result of Poland's foreign reserve management policy. Poland began this practice in 2011, and it has since moderated the swings in its currency's exchange rate. Belka observed that treasury bond yields are coming down, which is not a surprise, as "everything is coming down in today's world." The Warsaw Stock Exchange Index shows no signs of an asset bubble, he added. This is due to actions initiated in 2009, when Poland took steps to create a more stable housing mortgage market. The lesson Belka drew from Poland's experience is that it is possible to prevent financial instability, avert asset bubbles, and maintain a relatively stable exchange rate as a first line of defense against capital inflows.

Belka noted that none of the available policy tools have been completely effective, yet Poland has managed to weather the storm. He referred to Poland's policy as "a strategy of leaning against the wind." Central bankers try to find a middle ground between an interest rate that is low enough not to attract too much carry trade and high enough not to destabilize domestic savers and investment behavior. A floating exchange rate is helpful in many ways, and, Belka remarked, it is good to show the flag on the foreign exchange market from time to time so that short-term investors (i.e., speculators) do not start to believe that they live in a world where there is no risk.

Macroprudential policy is also quite important. Poland is in the early stages of creating a macroprudential regime, and some of its experiments are proving to be successful. For example, Polish banks were persuaded to drop foreign exchange mortgage loans, and it worked without the need to implement any drastic measures to eliminate this kind of lending. Similarly, Poland is currently implementing more macroprudential instruments to reduce the risk of asset bubbles in the real estate market in the future. Overall, Belka concluded that, for the time being, Poland has good reason to stay outside the eurozone.

LÍZAL observed that banking union is one of the proposals that has been widely discussed as a way to improve financial stability. Whether a banking union is “good” or “bad” depends on whether you are “in” or “out” of the eurozone, and, by association, the banking union. He noted that the benefits of banking union would clearly be greater for states with more fragile financial systems. Some have argued that a benefit of banking union is the effective transmission of monetary policy, but Lízal disagreed insofar as a small open economy, such as the Czech Republic, can do quite a bit with monetary policy on its own. Despite a protracted recession, he observed that the Czech financial sector is healthy, and has even been providing liquidity externally. As a country outside the eurozone, a banking union would benefit the Czech Republic insofar as it would help to resolve some of the issues within the eurozone.

Lízal next discussed the potential of a banking union to prevent banking crises in the future. He noted that the scope of the mechanisms (e.g., resolution funds) designed to address future crises may be adequate to address a small crisis but wholly inadequate to deal with a large one. Ultimately, he observed, a lender of last resort will be necessary. However, he pointed out that the creation of such an entity is a political issue and thus cannot be resolved by the creation of a banking union.

A banking union should help to eliminate the vicious cycle between the banking sector and sovereigns. If new regulations are created that require more capital or higher reserves but continue to treat government bonds as riskless, it is important to recall that the last crisis revealed that government bonds are not without risk. Lízal also observed that there has been very little discussion of risks coming from outside the eurozone. The Baltic countries, for example, have close ties to the Russian economy and would therefore suffer much more than other countries if the Russian economy were to falter.

Lízal next discussed the implications of a banking union that functions as a central bank or as a regulator. In the Czech Republic, virtually all the banks are foreign owned, with the majority of the owners based in the eurozone. This makes home-host issues very important. For example, healthy domestic banks that are foreign owned might be used to prop up their parent banks outside the Czech Republic. This has not happened yet, but it is a risk. In this sense, joining a banking union when an individual country already has a healthy banking sector is not a very appealing proposition. However, joining the banking union is a requirement for eurozone membership.

In terms of financial stability and macroprudential policies, the goal is to increase the stability of the financial sector, whether you are in the eurozone or not. Macroprudential policies are an important part of this effort. The Czech banking sector is resilient and has been made more so with recent improvements, including the introduction of buffers (i.e., loss-absorbing capacity) and larger capital requirements for systemically important banks.

Turning to stress testing, Lízal recalled that the Czech Republic experienced a banking crisis in the 1990s that led to the implementation of frequent stress testing well before such practices were adopted at the European level. The Czech Republic’s stress tests tend to focus on severe, low-probability risks. For example, a recent scenario modeled the impact of deflation in Europe on the Czech banking sector, with

a period of low inflation or deflation in Europe leading to another recession. The test revealed that the Czech banking sector could weather such a scenario provided it had access to additional capital. These kinds of results, said Lízal, lead us to conclude that even with an uncertain future, the risks of financial instability in the Czech Republic are relatively moderate.

Lízal observed that the current financial crisis resulted in an increase in public debt to levels that threatened financial stability. He offered an alternative calculation of the debt of various countries that includes public and private sector debt as well as the implicit debt (i.e., the promised benefits under the social welfare and pension systems and the expected costs of health care in the future) of each country. He cautioned that the implicit debt is typically much larger than the explicit obligations. And, as these implicit debts become explicit in the future, there will arise a real problem, not with financial stability, but potentially for monetary policy.

There is also the issue of low inflation, which increases the cost of the debt and in turn poses a threat to financial stability. Lízal related how the Czech Republic was in a very bad situation in 2013, with inflation close to -1 percent, a level similar to that in Greece and Bulgaria. The Czech Republic adopted an approach proposed by Sven Larson, a member of the Swedish Central Bank (the approach was not official Bank policy). Larson argued that in the presence of zero interest rates and a set of deflationary factors, the exchange rate might serve to anchor the inflation expectation, and, by a commitment to a depreciated exchange rate, it is possible to increase inflation; this has worked in the Czech Republic.

Lízal concluded that small open economies that are close to the eurozone might have problems setting truly independent monetary policy, but in bad economic times, if such countries use a variety of tools, national governments can be quite effective. On balance, it can be beneficial to have the option to retain control of national monetary policy.

SESSION 3

Can the Periphery Countries Return to Growth?



Stuart Holland, Megan Greene, George Skafidas, Eckhard Hein, Michalis Nikiforos

MODERATOR:

GEORGE SKAFIDAS

Ethnos

STUART HOLLAND

University of Coimbra; Institute for Social and European Studies, Hungary

MEGAN GREENE

Manulife Asset Management

MICHALIS NIKIFOROS

Levy Institute

ECKHARD HEIN

Levy Institute; Berlin School of Economics and Law

HOLLAND observed that it is commonplace to blame the current crisis on the design flaws of the euro. However, he has long argued that the design fault is much deeper, and is found in such factors as the supernationalism of Jean Monnet and his support for the European Coal and Steel Community, the creation of the European Economic Community, the European Free Trade Association, and political distractions contemporaneous to the signing of the Treaty of Rome. After reviewing aspects of the historical evolution of the eurozone, Holland examined options for the future. He noted that while the design of the euro was clearly flawed, until the eurozone debt crisis, the design seemed to work: interest rates on government bonds were almost synchronized at low levels, and there was no great divergence.

Holland argued that under the euro, Europe has been locked into Germany's policy preferences, and a Germany with a profoundly deflationary bias. The obsession of the Bundesbank historically has been that public spending risks inflation, a fear that some connect to the rise of Adolf Hitler.

Holland argued that this is a false association, and that, in fact, deflationary policies accompanied the popular support for the Nazi Party in the early 1930s.

Holland observed that the historical opportunities for a confederal Europe, not a dictatorial troika, were missed repeatedly, as was the chance for joint European planning. He cited the example of Robert Marjolin, the first French vice president of the European Commission (EC), who proposed a medium-term economic policy committee to analyze emerging internal contradictions in Europe. This is but one example of how many of the problems faced by Europe today could have been foreseen and avoided, but were not. Similarly, Jacques Delors, president of the EC from 1985 to 1995, invited Holland to set out an alternative agenda for Europe. The Single European Act of 1986 followed—the first revision of the Treaty of Rome. The Act committed Europe to something totally ignored in recent debates: economic and social cohesion.

Holland stated that he never believed that Europe would achieve cohesion through fiscal transfers between member-states. In his opinion, the American New Deal provides a better paradigm. President Roosevelt did not reduce unemployment using classic Keynesian fiscal stimulus; he did it by using bonds, to shift savings during a depression into fixed-interest bond borrowing and investment. Holland related that he recommended to Delors that a European Investment Fund (EIF) be created that could issue bonds and recycle global surpluses. The EIF is now the sister institution of the European Investment Bank (EIB) in the EIB Group. Thus, this capacity currently exists. However, it has done virtually nothing since Delors set it up in 1994, although it remains available. Put another way, said Holland, the bonds that are so anathema to German Chancellor Angela Merkel and Finance Minister Wolfgang Schäuble do not need national guarantees, fiscal transfers, or treaty revisions. They could be exploited today to address many of the issues in the eurozone.

Holland next turned to EC President Jean-Claude Juncker's €315 billion investment and recovery plan for the eurozone. He noted that the 60 percent Maastricht debt limit has been described as reconciling stability with growth. However, the issue of EIB and EIF bonds from a low base would have multiplier effects, which could be very high; EIB investment multipliers have ranged from 2.5 percent to 3 percent. And then, attached to that, there are fiscal and income multipliers. The money to purchase such bonds could come from recycling global surpluses, not, for example, from Germany. To this point, on September 25, 2014, the BRICs stated that if Europe would issue eurobonds for recovery and growth, they would invest in them. There are currently vast global surpluses of uninvested savings.

Holland noted that there is one great asset that never appears in the press: EIB bonds do not count as national debt. This is an enormous asset, because the criteria in the 1997 Amsterdam Special Action Programme for growth and employment are wide-ranging, and include investment in health, education, urban renewal, the environment, and green technologies; whereas the press is now focusing on what the criteria will be for this investment-led recovery Holland pointedly recalled that the European Council has already defined a set of policy priorities, but this has been forgotten in the current debate.

Holland concluded that Europe already has a public sector borrowing requirement with vast potential. There is no need to invent new tools or authority—they are already in place. What is needed, he said, is action—now.

GREENE addressed the issue of whether the periphery can return to growth. She stated at the outset that the periphery *can* return to growth, but that she remains skeptical as to whether this will happen. She

suggested that it would take approximately a decade, not unlike the Japanese-style lost decade, with extremely low growth and extremely low inflation.

She observed that the approach to the eurozone crisis thus far has been to try to make weaker economies behave more like Germany. However, Germany's growth model is based on a high level of national savings. Germany has exported its savings in the form of investments to other countries, primarily in the eurozone, for the past 15 years. The policy goal has been for weaker economies to undergo an internal devaluation by cutting wages and prices, with the expectation that prices will fall and competitiveness will rise. This adjustment process is happening in the weaker countries, but not in the stronger ones.

This strategy, Greene reported, has not worked well for the periphery, nor has it been working well for Germany lately. Germany has seen its exports, industrial production, and new orders fall, yet many German policymakers remain in denial about this fact. Greene argued that if Europe is to avoid a Japanese-style lost decade, a totally different approach to this crisis is needed—an approach in which the adjustment is much more symmetric.

She then turned to what Germany needs to do differently. The country suffers from chronic underinvestment domestically. Yet, today, Germany faces record low borrowing costs. What better time to borrow and rebuild its decrepit infrastructure? Greene noted that Germany is not against investing domestically, but it does face questions about how to do it. Germany remains wedded to fiscal orthodoxy. Its leadership has announced some measures to increase investment domestically and perhaps increase government borrowing, but these initiatives will not take effect until 2016. This is not nearly enough or fast enough, said Greene. Part of the problem is that Germany does not really think it needs growth. In addition, Germany believes the current crisis is the result of other countries' mistakes; therefore, Germany does not think that it can really do anything about the crisis. Finally, Greene offered a political explanation of why a shift in this approach to the crisis is unlikely. *Alternative für Deutschland*, an anti-euro party in Germany, has gained considerable support lately and is putting considerable pressure on Merkel and Schäuble.

Going forward, Greene suggested that three things are needed. First, there must be a different approach to the crisis, but, in her assessment, this is unlikely to happen. Second, the European Central Bank (ECB) needs to step in and purchase sovereign debt. However, Greene thinks this is also unlikely, since sovereign yields across the eurozone are, at present, very low relative to fundamentals. If the ECB did take action, Greene argued that it would help in two ways: (1) it would cause the euro to depreciate to a significant degree, and (2) it would buy time and space for policymakers to implement difficult, unpopular structural reforms. The problem in Europe, Greene suggested, is that policymakers are only going to push through reforms if they have no other choice. However, as long as the ECB buys them time and space, policymakers will not be willing to implement difficult reforms.

Turning to the results of recent ECB stress tests, Greene noted that there is an ample supply of credit in the eurozone, but the problem continues to be a lack of credit demand. Companies are hoarding cash while they try to figure out what is going to happen next. This will be exacerbated over the next year, given the election cycle in Europe. Political instability, therefore, will be a big risk for the region.

The third thing the eurozone needs is a massive debt conference whereby all the countries in the region meet and decide to write down the net present value of the debt. But despite huge retrenchment

by countries in the eurozone periphery, public debt-to-GDP ratios have gone up and up since the onset of the crisis.

There are, Greene offered, three ways to deal with high public debt. One way is economic growth, but there will be relatively little growth in Europe over the next decade; another is inflation, but there will be relatively little inflation over the next decade as well. The third way is to write down some of the debt. This is what is needed, said Greene, so that countries can start anew. A writedown would deal with the debt-stock problem, although it would not in and of itself deal with the stock-flow problem. It would, however, unlock some of the transmission mechanisms for monetary policy and get credit flowing in the system again. In closing, Greene said she expects to see a debt conference in the next 10 years, and that it will be hugely disruptive to markets.

NIKIFOROS addressed the relation of the “twin deficits” of the Greek economy (i.e., the causal relation between the public and the external deficits of the Greek economy). He argued that in the period after 1995, because of the monetary unification process, and, later, the adoption of a common currency, the direction of the causality between the foreign deficits and the public deficits in Greece runs from the former to the latter. In other words, the growing foreign deficits explain the growing public deficits.

Nikiforos began by reviewing the relevant accounting identities. He noted that these identities require that a current account deficit must be matched by a deficit in the private sector or the government sector. He recalled that there are several theories on how the causality between these three variables operates. The most common hypothesis offered by neoclassical economists is the “twin deficits” theory, in which it is the fiscal deficit that causes the external deficit. The literature provides two main transmission mechanisms. First, based on the loanable funds theory, a high fiscal deficit increases the demand for loanable funds. This drives up the interest rate and causes capital inflows; as a result, the exchange rate appreciates and lowers the current account balance. The second is a more direct mechanism, wherein the fiscal deficit increases demand. Higher demand leads to increased prices, which in turn reduces the current account balance.

Nikiforos argued that in Greece, after the Maastricht Treaty was signed in 1992, the external deficit drove the public deficit. Thus, for reasons exogenous to the fiscal stance of the government, the country’s foreign position deteriorated. In a case such as this, the fiscal deficit adjusts to stabilize the economy. This can happen either through automatic stabilizers or through active policy decisions. He noted that a necessary condition for such an adjustment is a sufficient inflow of foreign capital and the ability of the government to borrow at a relatively low interest rate, as was the case with Greece in the period following the signing of the Maastricht Treaty in 1992.

Next, using a financial balances approach, Nikiforos examined the development of the Greek economy since the 1980s. His team’s initial analysis led to the hypothesis that in the period after 1995 the causality between the two deficits ran from the foreign deficits toward the public deficits, and the foreign deficit displayed autonomous behavior. Nikiforos explained that after Maastricht, monetary, fiscal, and exchange rate policies focused on low inflation. Consistent with these goals, Greece made a concerted effort to comply with the Maastricht rules, and achieved a very low inflation rate in the 2000s.

The 1990s were a critical period for the development of the Greek economy, he observed. The decade began with the signing of the Maastricht Treaty, and the initiation of monetary unification. In 1993, the controls on long-term capital movements were removed, and in 1994 the controls on short-term capital movements were also removed. The result was that inflows of capital from all over the world could come

to Greece freely. In 1995, the governor of the Bank of Greece announced that the Bank's main objective would be a further decrease in the inflation rate and the implementation of the "hard drachma" policy.

Between the collapse of the Bretton Woods system in the early 1970s and the early 1990s there was a generally stable real effective exchange rate. After the early '90s and until 2010, Greece recorded a real currency appreciation of almost 40 percent. Greece has never been a very export-dynamic or export-led economy, Nikiforos noted, and a 40 percent increase in the real effective exchange rate is something that no economy could cope with.

Comparing the real effective exchange rate with the current account deficit, Nikiforos observed a strong correlation between the two. When the real effective exchange rate appreciates, the current account deficit starts to increase simultaneously. He noted that there is widespread consensus in the literature on Greece that 1995 is a year that marks a structural break for the country's economy, usually with a positive connotation. Greek policymakers and the Greek economists of the time were aware of the pressures on the foreign sector of the economy due to both the "hard drachma" policy and the policies implemented under the Maastricht Treaty.

However, it was not only Greek economists or Greek policymakers who were overly optimistic at the time. Many economists, both within and outside of Greece, dismissed looming problems. A convergence argument was made that because of scarcity of capital in the European South, and an abundance of capital in the European North, there would be higher returns to capital in the South than in the North. Nikiforos and his team also tested this hypothesis econometrically, and found that, after 1995, the causality ran from the foreign deficits to the public deficits, not the reverse.

To conclude, because of the policies that were adopted following the Maastricht Treaty, the increases in the public debt during that period came from increasing pressure on the external sector. So from a policy point of view, the only way to achieve sustainable fiscal consolidation is to try to deal with this extremely large foreign deficit. Nikiforos concluded that this is the sole path to simultaneous growth and fiscal consolidation in the Greek economy.

The research **HEIN** presented was funded by the European Commission and the Seventh Framework Programme. He proceeded with his remarks based on three premises: (1) current policies to deal with the crisis and the imbalances have failed, (2) the dissolution of the eurozone or the breakup of the euro is not a desirable option, and (3) we are unlikely to have a fully developed currency union in the near future. Hein then discussed the possibilities for dealing with two related problems: rebalancing the euro area, and dealing with the problem of effective demand failure. He explained that the rate of growth of an economy depends on both its price competitiveness and its competitiveness in terms of the quality and composition of its output or exports. Using this framework, the current account imbalances can be seen from two perspectives: either inflation differentials are too high, or they are a result of inappropriate income elasticities in the demand for exports and imports.

Hein stated that the goal of policymaking must be to achieve high noninflationary demand growth in the euro area as a whole, preventing export-led mercantilist and debt-led consumption development (i.e., prevent the type of development currently seen in Europe). In the short run, he argued for stimulating aggregate demand and growth in the current account surplus countries relative to the euro-area average trend and adjusting inflation differentials through the adjustment of nominal unit labor cost growth. In the long run, Hein argued that Europe must improve the nonprice competitiveness of the countries that previously ran current account deficit countries and develop stable financing mechanisms

for the current account deficits that might remain as a result of some economies catching up in terms of productivity.

Hein next offered his proposal for a policy package to address these issues. All of its elements would be coordinated between policy areas (e.g., monetary, fiscal, and so on) and geographically coordinated with a strategy of industrial and regional development in order to enable the periphery countries to catch up.

Wage policies under this proposal would contribute to stabilizing income shares and inflation at the euro-area target rate. Specifically, said Hein, nominal wages should grow at the long-term trend rate of productivity growth of each respective country plus the inflation target for the euro area as a whole. Under his proposal, labor market flexibilization and increasing competitiveness through nominal wage restraint would be abandoned. Instead, policies would focus on the reregulation of the labor market, the stabilization of trade unions, and the involvement of governments.

Regarding the role of the ECB and monetary policy, Hein argued that monetary policy should refrain from fine-tuning inflation, employment, or growth, as it will not provide the level of stimulus needed. Instead, monetary policy should target low real interest rates for distributional reasons, and focus on financial stability using measures such as credit standards, reserve requirements, and credit controls. And, most important, the ECB should act as a lender of last resort to the banking system and euro-area member countries.

Returning to the theme of rebalancing the euro area, Hein said that the major burden for rebalancing falls on demand management and therefore fiscal policies. Under his proposal, fiscal policy would focus on real stabilization of full employment and improving the distribution of income. A balanced current account as a long-run target for each of the member countries would mean that the government deficit in each country should in the long run be equal to the excess of private saving over investment at high levels of employment. Hein's policy proposal implies abandoning the Stability and Growth Pact and austerity policies, but it does not mean abandoning coordination. He next discussed the desirability of balanced current accounts in a currency union that is as heterogeneous as the euro area.

With this proposal in place, Hein explained that the catching-up process for the South would have three prerequisites: (1) the prevention of unsustainable credit-driven bubbles and consumption booms, focusing capital inflows on productivity-enhancing investment; (2) the development of export capacities to improve the balance-of-payments constrained growth rates of the South within an integrated regional and industrial development strategy; and (3) the financing of current account deficits related to successful catching up. Regarding this last prerequisite, Hein's proposal uses financial regulations such as liquidity requirements, financial transaction tracks, and so on to influence the maturity of private capital inflows to the catching-up countries. In addition, he recommends pooling large parts of investment spending at the European Union (EU) level and focusing on the catching-up countries. These efforts could fund one or more of the proposals that have been made, such as member-country contributions, EU taxes, and EU debt.

Hein concluded that while we do not have a perfect solution for all the challenges Europe faces, the progressive movement can put forward a package that integrates the macro aspects or the policy mix between monetary, fiscal, and wage policies with the idea of industrial and regional policies in order to facilitate catching up.

SESSION 4

Threats to European Recovery



Andrea Terzi, Engelbert Stockhammer, Peter Bofinger, Elga Bartsch, Alexis Papahelas

MODERATOR:

ALEXIS PAPAHELAS

Kathimerini

ELGA BARTSCH

Morgan Stanley

PETER BOFINGER

German Council of Economic Advisers;
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ENGELBERT STOCKHAMMER

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BARTSCH opened her remarks with an analysis of some of the long-term factors preventing the European recovery, and the possibility of secular stagnation in Europe. Secular stagnation risks include deleveraging across several sectors, both public and private, as well as risks stemming from an ageing population, energy costs, and geopolitical tensions. She also discussed the German economy, noting that while it is operating near full employment and appears to have no major impediments in terms of credit availability, there is a profound degree of underinvestment in both the private and the public sector. Bartsch also addressed the role of structural reforms, notably the liberalization of product and labor markets in Europe. She observed that problems in the labor market are exacerbated by the current low-inflation, or “no-flation,” situation. Finally, she discussed monetary policy options to foster the recovery, through the creation of what she described as a “credit impulse.”

Bartsch observed that the 10-year outlook for the euro area is a real growth rate slightly above

1 percent annually. She noted that this low growth rate is not cast in stone and could be increased with the implementation of structural reforms. She suggested that Europe has an enormous amount of entrepreneurial talent and human capital that could be made more productive through structural reform. The region also exhibits a declining trend in total factor productivity, which will not improve without the renewal in the capital stock.

Weak investment in both the core and the periphery countries is a profound concern, said Bartsch. She noted that investment spending in Germany has been very weak for at least a decade and will eventually affect all of Europe. This low level of investment, she explained, is one of the main reasons why Germany should not be overly proud of its current account surplus. A financial balances approach shows that for the last 10 years the German corporate sector has been a net saver. It is very unusual, Bartsch observed, for a corporate sector to be a net saver—the corporate sector should be bursting with new ideas, new technologies, and new products, and thus be a net investor.

Looking at ways to change the low potential output growth, Bartsch presented estimates developed by the Organisation for Economic Co-operation and Development (OECD). These estimates illustrate the maximum impact on GDP per capita over a 10-year horizon, assuming countries embarked on a set of regulatory changes devised by OECD economists, and indicate that the average euro-area economy could see a 15 percent gain in GDP per capita over a 10-year period. Bartsch pointed out that many of the recommended regulatory changes focus on the liberalization of closed services sectors and regulated professions, but do not include labor market deregulation.

Bartsch explained that she is less fearful of a Japanese-style “lost decade” and more concerned that Europe faces a future of low-growth, no-inflation equilibrium. This scenario includes headwinds from the debt overhang in the public and private sectors, which are hampered by a comparatively slow deleveraging process in Europe, which could have the effect of holding back credit creation.

A useful indicator of credit creation is the number of new loans originated for small- and medium-size enterprises, which for the first time in seven years are positive on a year-on-year basis. Bartsch noted that, unlike the United States, the credit cycle in Europe lags behind the economic cycle. Thus, the credit cycle cannot really jump-start the European economy; rather, it must support it. Bartsch argued that Europe needs European Central Bank (ECB) policies to drive bank funding costs down and ensure that banks are adequately capitalized. Competition in the banking system would force banks to pass lower funding costs to their customers. Initially, this will likely cause a refinancing wave, reducing the debt service burden and freeing funds for other purposes; but eventually, it will support credit growth.

Bartsch next presented an analysis of financial fragmentation carried out by Morgan Stanley. They created synthetic cost-of-financing indicators for euro-area countries, for both the household and corporate sectors. The analysis showed that fragmentation was only an issue for the corporate sector, where the discrepancy between funding costs by country sometimes differed by more than 500 basis points. These costs came down materially with the Outright Monetary Transactions promised by ECB President Mario Draghi. Bartsch’s expectation is that this will continue with the targeted longer-term refinancing operations that the ECB is offering because these are very attractive for the banking systems in the periphery. She next briefly reviewed some of the external issues that have caused the recovery to sputter, including the downturn in, and sanctions against, Russia, and the associated geopolitical uncertainty. These events contributed to a marked slowdown in some of the bigger emerging economies.

However, she also noted that there are some signs of improvement. Manufacturing, services, and retail companies are revising their expectations upward. There are indications that the economy is gradually turning a corner, and it appears Europe is on track for gradual recovery (i.e., growth in the euro area increased from 0.2 percent quarter-on-quarter in late 2014 to twice that rate, 0.4 percent quarter-on-quarter, by the end of 2015). On the whole, she predicted that the euro area will have an average growth rate of roughly 1.5 percent for the period 2015–16. This growth rate will leave the region vulnerable to further shocks. Thus, she concluded, there is a clear need for the ECB to continue its expansionary policies.

BOFINGER focused his remarks on threats to the European recovery and how to put the regional economy back on track. The German prescription, he noted, consists of consolidation and unspecified structural reforms. Thus far, it seems that Germany sees its contribution to the European growth process strictly in terms of having a balanced budget. Bofinger began with a discussion of development of the euro-area economy and then offered policy suggestions going forward.

He noted that until 2007–8, the euro area was doing fairly well, but then faltered in its recovery compared to other regions of the world. He explained that Europe fared poorly after 2007–8 because the euro area was unable or unwilling to provide the fiscal stimulus required to address the crisis. Countries such as the United States and the UK had already implemented the structural reforms many have called for in Europe, but it was the aggressive fiscal stimulus policies launched by these countries that made the difference in their recovery.

Turning to an analysis of financial balances, Bofinger used an indicator of the private financial balance (i.e., the current account balance minus the fiscal balance) to show that there were positive private sector balances as a result of the crisis, which is unusual: according to standard textbook economics, these private sector balances should be zero. He argued that Europe failed to implement an adequate fiscal policy response to offset private deleveraging in the euro area, which in turn had a negative impact on growth. The same observation applies to the ECB's slow monetary policy response. Remarkably, the ECB actually increased interest rates at the beginning of 2011. Likewise, the ECB's quantitative easing response was weak. In sum, Bofinger observed, the euro area suffered from an insufficient fiscal policy response as well as an inadequate monetary response.

Today, Bofinger noted, the situation has stabilized, and there are some positive developments. Some have attributed these improvements to structural reforms, often citing Spain as an example. However, Bofinger suggested that the current stability is because consolidation has stopped. A number of countries have realized that too much consolidation is dangerous and that some amount of deficit is needed. Another hopeful sign is that the ECB has realized it must expand its balance sheet, which means a very strong increase in the monetary base—though Bofinger expressed some concerns as to how banks could respond to the ECB's policy. ECB purchases of government bonds, he noted, pose mainly political risks. Some of the resistance to this move stems from low long-term interest rates in Germany. ECB purchases could threaten German private pension schemes—the main source of household wealth in Germany. Bofinger suggested that the positive economic impact of buying government bonds would not be worth the political problems it would create. Overall, he noted that the ECB has had a positive impact in addressing the crisis.

Even with positive signs of growth, underlying problems remain. It is expected that unemployment rates in countries such as Spain and Greece will remain very high until 2016. Debt levels are also likely to remain well above normal. Similarly, the International Monetary Fund's forecast debt-to-GDP ratio for the European Union (EU) will remain very high, which means that countries will be very vulnerable

to panic in the financial markets. Reviewing the levels of public debt within the EU, Bofinger described the consolidation effort as absurd—debt levels are higher today than in 2009–10. Bofinger next discussed some of the policy alternatives that have been advanced to address the current situation.

Structural reforms have been put forward as a strategy to spur growth. Yet there seems to be little evidence such measures work. For example, Germany is the worst performer out of more than 30 countries in terms of structural reforms—it has one of the most heavily regulated labor markets in the world. In contrast, France is regarded as a poor implementer of the sorts of policies many argue are necessary for growth, but in terms of GDP growth France is not doing much worse than the UK—the country seen as ideal with regard to structural reforms. Yet the UK has run very high fiscal deficits, its currency has depreciated, and it has implemented very aggressive quantitative easing measures.

Bofinger explained that Germany's success relies on wage moderation (i.e., flat wages). The problem is that the German model cannot be applied to all euro-area countries because it only works if no other country employs it. If all European countries implemented this strategy, the result would be deflation. It is therefore very dangerous to use Germany as a model.

Rather, Europe needs more investment. The reason Europe does not have more investment is because of poor demand, but it risks reduced competitiveness in the future if it does not invest. Bofinger argued that if the private sector does not invest and there is strong deleveraging, investment must come from the public sector. He proposed applying the “golden rule” for investment, noting that safeguards could be added to reduce waste and ensure proper selection and management of public projects. Structural reforms could be included, if needed, as a way to satisfy German public opinion. Thus, he concluded, Europe should pursue a two-pillar strategy of structural reforms plus investment. Paired with increased investment, structural reforms might have an impact.

STOCKHAMMER argued that it is the region's neoliberal-inspired economic policy regime that created the current crisis. He asked, why did a crisis that started in the United States due to the overextension of credit lead to a more severe crisis in Europe than in the States? Further, why did this crisis become a sovereign debt crisis for European countries but not for other countries?

He began with the observation that Europe has two growth models: export-driven growth and debt-driven models. Both are intrinsically unstable, require increasing levels of debt, and are thus unsustainable. The main difference between the two models is that the debt-driven growth model requires rising debt within a country, whereas the export-driven growth model requires debt to increase externally (i.e., rising trading partner debt). In addition, Europe has an economic policy regime that severely restricts how governments react to crises. The EU also introduced a separation between monetary and fiscal policy that modifies the effects of monetary policy.

Stockhammer next reviewed the levels of household debt and the current account balances to illustrate the presence of export-led and debt-led growth regimes in Europe. In Germany, for example, roughly three-quarters of aggregate demand growth in the decade prior to the crisis came from net exports. In contrast, the United States and the southern European countries (i.e., debt-driven countries) ran large current account deficits. The United States and the UK responded to the crisis with massive quantitative easing programs and strong countercyclical fiscal policies. In contrast, the European policy regime—essentially the Stability and Growth Pact (SGP)—made it more difficult for countries to run deficits. As a result, the crisis worsened in European countries and soon became a sovereign debt crisis, unlike in other countries with high debt levels.

Stockhammer argued that several factors are contributing to the ongoing crisis. Current treaties are a big part of the problem, he noted, and must be part of the policy debate. Under the current policy regime there is no central fiscal policy, and limited national fiscal policy. Further, European monetary policy has had a strict anti-inflationary strategy and placed less emphasis on growth or real targets compared to, for example, the United States and the UK. Thus, the European system is effectively a system in which economic policy is tied to the mast of the Maastricht Treaty and the SPG. Under the current policy regime, the only area where there is potential flexibility is labor markets. However, Keynesians have long argued that labor market flexibility does not work. In chapter 19 of his *General Theory*, Keynes is quite explicit that in a recession with high unemployment, cutting wages is counterproductive. Wage stability is an important source of demand, and wage cuts can lead to a debt-type deflation process. Stockhammer noted that the troika's policy package is misguided, in that the main adjustment burden has been put on the deficit/crisis countries, not the surplus countries, further confounding a recovery.

Reviewing the current state of the European recovery, he noted modest growth in exports but observed that internal demand in the euro area remains roughly 5 percent less than what it was in 2008—Europe has essentially flat domestic demand. Household debt in the euro area has also remained flat, and therefore it is unlikely that Europe will see much credit growth or increasing aggregate demand. Further, the ECB's quantitative easing program has been far more cautious than the measures implemented by the Bank of England or the Federal Reserve—reflecting, Stockhammer suggested, the ECB's reluctance to take on the role of lender of last resort for governments. The ECB does, however, seem to accept its role as lender of last resort for the private sector. From a post-Keynesian point of view, the ECB misunderstands the roles of money and government debt. Insofar as the ECB refuses to act as lender of last resort for governments (i.e., buying government debt when no one else wants to buy it), it weakens the ability of states to react to the crisis. Thus, in Europe, the effects of quantitative easing are expected to be very different compared to countries that integrate monetary and fiscal policy.

Stockhammer argued that Europe needs a fundamental rethinking of its economic policy package; a more inflationary adjustment policy, with more of the adjustment coming from the surplus countries; and, implementation of a common minimum wage to strengthen the region's social protection and labor systems. European monetary policy should pursue a higher inflation target, one that would promote rebalancing without creating a depression in the periphery. The ECB should underwrite government debt much more explicitly than it presently does and should monetize a substantial part of member-states' debt. Unless Europe's economic policy regime enables countries to pursue expansionary fiscal policies in crisis, Stockhammer warned, it faces a troubled future, and, eventually, a growing share of Europeans will question the usefulness of the euro.

TERZI began with the observation that the largest threat to economic recovery in Europe is the continuation of self-inflicted fiscal pain. The European Commission's (EC) outlook for the euro area in early 2014 described a European recovery as "imminent." However, in its latest outlook, the recovery is described as "not only subdued, but also fragile." Terzi suggested that the commission's optimism is overstated and based on "less negative" trends in Europe, not positive signs of growth. He noted that while deficits have declined in recent years, it is not because growth is higher. Overall, GDP growth is significantly lower (as is inflation) and unemployment rates are significantly higher.

The rationale for using the fiscal instrument to promote growth, he explained, is that net government spending creates demand and thus stimulates the economy. However, some argue that if a government

loses fiscal space (i.e., exceeds its budget constraint), it can no longer use the fiscal instrument to counter a slowdown. This argument states that it is inevitable that the economy will slow down as fiscal space contracts, and government should then turn to measures such as structural and long-run policies, promote lower production costs, and reduce debt levels. This perspective allows that austerity slows down the economy, but it also maintains that the faster reforms are implemented, the sooner austerity can end. Seen from this standpoint, austerity is a painful but necessary response to limited fiscal space.

Terzi next explained how our model of the economy drives what we define as feasible policy options. Thus, it is important to note that the EC and European Central Bank (ECB) models are flawed in two significant ways. Both models neglect the fact that government budget constraints are institutionally driven and subject to change, and government borrowing for expenditures adds to private savings rather than absorbing private savings. These two misconceptions are connected to the idea of sound finance, and the rules based on this approach.

The “sound finance” perspective is informed by the fear that a government acting as both money creator and spender may pose a threat. Government, the argument runs, is biased toward overspending. Thus, governments are likely to create deficits and, to avoid inflation, they will borrow to absorb savings rather than print money. When the debt becomes unsustainable, governments have no other option but to monetize and then inflate away the debt. The European solution to this problem, Terzi noted, is a two-pillar constraint: transfer the monetary power to an actor with no spending authority, and set deficits or debt limits on the spending authority.

Terzi underscored that this constraint was designed to prevent inflation. However, this offers little justification for austerity, given that, today, Europe needs inflation. Quite the contrary, this seems to support the argument that Europe ought to monetize its debt to promote recovery. However, Terzi explained that monetization is really not enough, as it consists of withdrawing a central bank liability with an interest rate and swapping it for another liability that carries a yield. He noted that there is in reality no budget constraint, as all government debts are fundamentally sustainable so long as a central bank controls the bid and ask price for treasury securities.

Turning to the second flaw in the EC/ECB models (i.e., government borrowing to support spending funds private savings), Terzi stated that savings do not really fund—savings are funded. When government borrows and spends, he explained, it boosts the stock of net financial assets of the private sector. He next provided a brief analysis of actual private savings in the euro area from 1999 to 2014, and concluded that but for net exports, Europe would have experienced greater economic contraction than it did.

Historically, the fiscal instrument can operate in several ways, adjusting freely or restricted by policy decisions. Prior to 2010, the euro area let deficits adjust insofar as excessive deficits were national concerns. Since 2010, the euro area has irresponsibly blocked the fiscal instrument, said Terzi, as excessive deficits started to raise questions in the bond market. He argued that Europe may persist in its desire to live in the “fantasy world” of balanced budgets for a time, but not indefinitely, because balanced budgets are not sustainable. Further, policies aimed at deficit reduction underestimate the direct stagnation effects they have, and overestimate the expansionary power of monetization. In addition, current policies pressure governments to downsize. Terzi argued that it is not just the size of the deficit that matters, but also the size of the government sector. He closed with policy suggestions going forward. For example, Europe might benefit from a fiscal instrument at the Economic and Monetary Union level within a credible framework, perhaps designed to be pro quota in a way that does not require a transfer union.

SESSION 5

Responding to the Challenge of European Unemployment



Rania Antonopoulos, Steven Tobin, Kostas Kalloniatis

MODERATOR:

KOSTAS KALLONIATIS

Eleftherotypia

STEVEN TOBIN

International Labour Organization (ILO)

RANIA ANTONOPOULOS

Levy Institute

TOBIN opened his remarks with the observation that policies focused on growth, investment, and austerity have not delivered jobs, but have instead harmed labor markets. He reviewed some of the key labor market issues and challenges Europe currently faces, focusing on the effects of the policy responses to date. His presentation also included policy alternatives advanced by the ILO.

Economic growth in Europe has been relatively stagnant, with little employment growth except in specific countries. The countries experiencing job growth are those that responded quickly to the employment impacts of the crisis. Today, said Tobin, the risk of detachment from the labor force as a result of long-term unemployment is one of the biggest threats to Europe. Twelve million people in Europe have been looking for a job for more than a year; of these, nearly nine million have been looking for work for more than two years and roughly two million are youths. Tobin also discussed the impact of income support programs and employability measures (i.e., active labor force programs) during the crisis. He noted

that there has been increased funding for income support but that more employability-oriented measures are needed, and these kinds of programs have seen a marked decline. He explained that while some countries have committed resources to training the unemployed there remains a disconnect between unemployment levels, training, and the difficulty employers have in finding suitably trained employees. Even in countries with astronomical levels of unemployment, such as Greece, employers report difficulty in finding qualified workers.

The health of small- and medium-size enterprises (SMEs) is important for job growth, Tobin explained, because these firms drive growth in Europe. For example, the share of employment in microfirms (i.e., firms with fewer than 10 people) is quite high in crisis-hit countries like Greece, Portugal, Spain, and Italy. Thus, SMEs, in particular microfirms, are very important for job creation. But these firms are not receiving the support that they need, even while many large banks have been recapitalized.

Tobin observed that one of the key risks of a prolonged recession is people taking jobs that do not match their education or training, or that do not pay in proportion to their education and skills. Yet, people who find any work at all are regarded as the “lucky ones.” The nine million unemployed who have been looking for work for more than two years risk leaving the labor market entirely. This can lead to social exclusion and skills erosion. Tobin warned that these kinds of changes in the workforce and within society affect the strength and health of public finances, which are very much determined by people working and paying taxes. Sadly, this point seems to have been lost in the current debate.

Turning to policy options, Tobin began with a discussion of structural reforms to ease the administrative burdens of starting a new business. He noted that much of the assistance businesses receive is front-loaded, with very little support provided after the business is founded. In addition, “competitiveness” is often described solely in terms of cutting wages. However, wage cuts are counterproductive for an economy that is principally based on consumption and domestic demand (e.g., Greece).

Tobin emphasized that policies to improve the labor supply require designing and delivering services using effective targeting. It is the “disadvantage,” not necessarily the disadvantaged *groups* that must be targeted. In terms of implementation and delivery, institutions must be strengthened; specifically, through the provision of public employment services to ensure that there is sufficient capacity to deliver programs efficiently and effectively.

He also discussed the pressing need to strengthen the linkages between income support, training, and employment activation. Training programs must be demand-driven to ensure that the newly trained meet the needs of employers, and social partners must be involved in designing such programs. He noted that program evaluation is a critically important function that is often cut in difficult financial times. However, data collection and evaluation are often neglected because policymakers think they know what works. The fact is, Tobin argued, we do not know what actually works, and evaluation is one of our most useful tools.

In terms of funding, these proposals require a relatively small amount of funding, which could be obtained by slowing the pace of fiscal consolidation or changing the composition of consolidation. Further, the cost of these programs must be viewed and evaluated as investments that bear future returns. Finally, he underscored the cost of inaction. Consider the 12 million people looking for a job for more than a year. If these people fall out of the labor force, the future costs will be profound. Growth and investment are not sufficient, said Tobin. Europe needs a comprehensive labor market and social policy, coordinated across countries, to complement these strategies.

ANTONOPOULOS presented research developed at the Levy Institute. She began with the current crisis in Greece, and provided an overview of labor market trends and conditions. She noted that construction and manufacturing, and wholesale and retail trade have suffered immensely. The number of unemployed in Greece rose from roughly 369,000 to more than 1.3 million in a matter of a few years, with huge increases in the poverty rate and greater vulnerability of falling into poverty. In January, Greek officials promised that 440,000 jobs would be created over the next two years. This was followed by another promise of 700,000 new private sector jobs within the next five years. Even under the most optimistic job-creation scenario, such as the 600,000 jobs estimated in a recent report issued by McKinsey & Company, 800,000 people will remain unemployed, and some of these will have been without a job for up to eight years. A bold policy strategy is urgently needed, she argued.

The late Levy Distinguished Scholar Hyman P. Minsky put forward the argument that it is the responsibility of the social state to guarantee a job when the private sector does not provide viable employment. The basic principles of his employer-of-last-resort proposal are: it is the responsibility of the state to offer the unemployed immediate access to a job, especially for people experiencing long-term unemployment and for low-income households; and a minimum monthly wage as well as social security and health care benefits. The central idea is that the monthly wage comes with all the rights attached to a job, and the program provides fiscal stimulus (i.e., it is an automatic stabilization mechanism). Antonopoulos argued that austerity has been tried and has failed to deliver job growth. The problem thus far has been that both fiscal policy and monetary policy responses have been procyclical. The job guarantee program is a much-needed countercyclical antidote to these policies.

She noted that the idea behind the program is to engage the newly employed job recipients in productive work that benefits the community, using a bottom-up process to define the reconstruction goals for Greece. Greece's most important resource, she argued, is not money or finance—labor is what creates wealth. In addition, the program is a way of moving from the individualistic “I” who is depressed and isolated into a community of “we” that has a transformative social purpose. Antonopoulos emphasized that what is distinctive about the employer-of-last-resort policy is its focus on the social dimensions of work. Work, she said, is fundamentally a social relation.

Antonopoulos next explained the macroeconomic impact of a fiscal expansion under a job guarantee program in terms of overall employment, GDP growth, tax revenue, and the distributional impact on the economy. The data were drawn from a pilot program implemented in Greece in early 2012. Undertaken in collaboration with the Institute of Labour of the National Federation of Trade Unions, the study used data on the characteristics of the people who applied under the pilot program, as well as Labor Force Survey and other demographic data sets. The macroeconomic simulation was based on input-output tables and standard multiplier analysis was used.

She then described the results of four job guarantee scenarios: (1) 200,000 directly created jobs, which is comparable to the number of people who applied to the 2012 pilot program; (2) 300,000 jobs, which is based on the number of unemployed whose characteristics matched those of the applicants to the 2012 pilot; (3) 440,000 jobs, which is equivalent to the number of job opportunities the Greek government had recently announced it planned to create over the next two years; and (4) 550,000 jobs, based on the mean and median methodology described earlier in Antonopoulos's presentation. She then described the results of these four scenarios in terms of costs, total employment increases, and impacts on GDP.

Antonopoulos noted that the first scenario of 200,000 jobs indirectly creates an additional 62,000 jobs. Likewise, the scenario for 550,000 jobs creates an additional 219,000, due to increased demand. The participants also pay taxes, which helps to offset the total cost of the program. Therefore, based on current wages, the net cost to directly create 200,000 jobs would be €1.2 billion, or €3.3 billion to create 550,000 jobs.

In terms of financing the program, she noted that there are a number of viable proposals that have been put forward, including funding from the European Investment Bank in the form of European investment bonds, and the establishment of a European unemployment fund. There are also funding proposals based on renegotiating Greece's debt agreements, and using the funds from, for example, a debt moratorium to fund an employment program.

SESSION 6

Austerity and Growth: An Impossible Alliance?



Joanna Kakissis, Heiner Flassbeck, Jan Kregel, Stephen Kinsella

MODERATOR:

JOANNA KAKISSIS

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HEINER FLASSBECK

UNCTAD, and Deputy Finance Minister,
Germany

JAN KREGEL

Levy Institute

STEPHEN KINSELLA

University of Limerick

FLASSBECK offered a quick “yes” to the question of whether there is an impossible alliance between growth and austerity. He observed that, until recently, everyone understood this fact. He offered that the reason for implementing austerity is more political than economic. Turning to historical cases in which austerity policies seem to have succeeded, he explained that such policies did not actually succeed. In the past, when countries experienced a financial crisis—and these were usually currency crises in reality—the International Monetary Fund (IMF) prescribed austerity and the country in crisis devalued its currency. Austerity was, and remains, the IMF’s standard policy response: when austerity was imposed, the vast majority of the crisis countries devalued their currencies dramatically, reviving their economies despite the negative effects of austerity. However, devaluation is obviously more complicated in a monetary union.

Flassbeck next discussed structural reforms, noting that, most of the time, such policies are essentially wage cuts in place of devaluation. He

stated emphatically that this is a terrible policy, one that represents the end stage of the Economic and Monetary Union (EMU). The time remaining to save Europe is dwindling, he warned.

Surveying current economic conditions, Flassbeck described Europe as being in a state of disaster, noting negative trends in industrial production, unemployment, and deflation. He asked why Europe is experiencing deflation, given that the European Central Bank's (ECB's) stance is as aggressive and expansionist as it can be. He suggested that there is a basic misunderstanding in the current debate—a debate that is more about economic ideologies than economic theories, a debate that is more theological than scientific.

Flassbeck explained that deflation in Europe originated with Germany. From the outset, Germany pursued deflation, not inflation. While the Maastricht Treaty called for an inflation target of 2 percent, Germany began its own neoclassical experiment of cutting wages. Thus, the origin of the crisis was wages, and nothing else. Flassbeck explained that prices reflect wages—specifically, unit labor costs. He then compared unit labor costs across the European Union (EU), and noted how lower unit labor costs, especially in Germany, resulted in losses for other countries, such as Greece. The difference in unit labor costs is more important, he argued, than such things as the price elasticity of exports or the current account balance. Thus, by undercutting its neighbors—in effect, devaluing—Germany exported its unemployment from the beginning of the currency union. Today, Germany is close to full employment, while other countries have rising unemployment. The coordination of wages requires exactly the contrary, Flassbeck argued. Therefore, wage suppression must be reversed to achieve anything like a solution for the eurozone.

In terms of the adjustment process, Flassbeck warned that there is no easy way out. Structural reforms are the main vehicle for cutting wages, and real wages have fallen dramatically since their peak in 2008–9. If workers do not have the wages to buy the goods they produce, more workers will become unemployed and the cycle will continue. The impacts of declining wages are clearly visible in the export shares of the southern European countries, including France and Italy. In these countries, the export share of the economy is approximately 25 percent and the remaining 75 percent is domestic demand. If nominal wages are cut by 20 percent, consumers will cut their expenditures by 20 percent, and declining investment, production, and employment will follow.

Based on the results of policies to date, Flassbeck argued that any rational person would conclude that this approach has not worked. The danger, he warned, is not of a “lost decade” for Europe but of no Europe. If unemployment reaches 20 or 25 percent, he predicted that right-wing, anti-Europe political parties will almost certainly come to power in France and Italy.

The solution to this crisis will not be found in academic descriptions of the problem, said Flassbeck. Political power is needed. One country, such as Greece, cannot change Europe's policy alone. A coalition, perhaps of the southern EU countries, is needed. In order to negotiate, this coalition must wield a credible weapon, such as leaving the euro. If a coalition is not able to at least threaten an exit, Flassbeck predicted, it would have no real power to negotiate and nothing will change. The only way to change European leadership's thinking is to threaten an exit and a devaluation. He noted that if an exit occurred, Germany would lose millions of jobs—and German creditors very much need their debtors.

Flassbeck offered three policy proposals for the immediate future. He advocated expansionary monetary policy, a wage adjustment over a period of 10 to 20 years, and, last, a huge fiscal stimulus program. Fiscal stimulus must be implemented explicitly, he said, and Germany must take the lead. Stimulus should take the form of an investment program. But, Flassbeck noted, investment takes too long, so a tax cut

would be needed to stimulate expenditure—mainly in Germany and perhaps in other countries where the deficits are very high. He offered that this should create a turnaround in the European economy in one year's time. If these kinds of policies are adopted, said Flassbeck, there is some hope of avoiding the worst outcome: political victory for the right wing.

Drawing upon his long observation of the Bundesbank's policies and its leadership, **KREGEL** suggested that current German policy can be interpreted as an attempt to profit from the crisis and build the kind of Europe that it has always intended but did not achieve through the EMU or the Maastricht Treaty. He began his presentation with a brief overview of the creation of the euro, recalling that the EMU developed in fits and starts, passing through a number of policy experiments until panic pushed the process of integration forward. He noted that Germany had insisted that rapid monetary integration and the creation of a single currency could not and should not take place. In a sense, these concerns anticipated the current crisis. For example, one observer wrote in the 1990s, "In a single currency system, without devaluation, negative external shocks will have to be met with increased downward flexibility in wages and conditions in labor markets."

Thus, Kregel argued, Germany could not stop the euro, so it adapted to the euro by reducing its fiscal deficits, cutting its social welfare system, holding wage increases below productivity, and so on. Today, Kregel suggested, Germany is using the current crisis to push for the kind of political integration it originally believed was necessary for the success of the euro. He also observed that in the absence of political integration, Germany pushed for controls to ensure that all of the other members of the euro would introduce policies similar to its own (e.g., Articles 104 and 123). For example, the rationale for the Stability and Growth Pact (SGP) reforms—the so-called "Six Pack" measures—was to avoid the moral hazard that Germany believed would be created by the gap between monetary and political unification.

The conditions that were imposed on fiscal policy and monetary policy reflect the absence of a political system that would impose these sorts of systems, said Kregel. By creating what is a de facto fixed exchange rate system without the backing of a national government means that government debt is effectively the same as private debt within this system. There is no longer any such thing as sovereign debt: the validation of the debt comes from the stability conditions—from the fiscal condition of the debtor government.

This sort of system, and the requirements to make the euro a sovereign debt, can be fruitfully analyzed using Minsky's definition of financial fragility. The fiscal conditions that are presently required for monetary stability, Kregel argued, are not conducive to stability of the system or stability of the currency. He explained that for a sovereign to have risk-free debt, it must run what Minsky called a hedge finance scheme. Specifically, a sovereign must run a large financial surplus if it is always going to be able to repay its debt.

Kregel explained that this requires the private sector to increase its tax payments. Therefore, the private sector has to either reduce consumption or increase savings. Also, the financial balances in any closed economic system means that the private sector and the government sector balances must sum to zero. Thus, for governments to run surpluses, the private sector has to run deficits: savings must be less than investment. The private sector has to become increasingly indebted. We find, therefore, a basic incompatibility: both of these sectors cannot be net savers.

The external sector offers a way out of this problem, said Kregel. Within the EU area, the fiscal balance that is required for sovereign government debt to be risk free requires a current account surplus

that at least offsets any private sector deficit, and the external surplus is crucial in determining the ability of private and government sectors to repay their debts. This requirement shifts financial fragility to the external sector. In the case of Greece, the most important external sector is the rest of the EU. Greece has little ability to increase exports rapidly, so the solution to the euro crisis or the Greek crisis cannot be found in Greece alone but in the surplus countries. Kregel noted that it remains a question whether this solution is stable. Would it enable eurozone governments to make their sovereign debt risk free? The answer to this is no.

Relying on external demand can provide stability; however, this is the definition of a Ponzi scheme, and Ponzi schemes are not stable. Thus, given the way the euro area is constructed and the requirements of the SGP, the survival of the euro requires, by definition, that the rest of the world continue to maintain a Ponzi scheme on a continuous basis. As John Maynard Keynes said in 1946, “It is obvious that no country can go on forever covering with new lending a chronic surplus on current account without eventually forcing a default on the other parties.”

Kregel concluded that we have seen similar dynamics before in the form of dollar scarcity in the postwar period, and we know exactly how that turned out. Unfortunately, Germany, which was on the deficit side of the dollar-scarcity problem, now finds itself on the surplus side, and there is no more possibility of it succeeding today than there was after World War II.

KINSELLA suggested that Ireland illustrates some of the principles discussed by several of the previous speakers. However, he noted that Ireland has an uncommon industrial structure and a particular growth model that is unusual. Austerity is said to have “worked” in Ireland, and some hold up Ireland as an argument for austerity. However, Kinsella cautioned that austerity did not in fact “work” in Ireland—as the data show.

He began his presentation by describing the run-up to the crisis, recalling a growing asset bubble, exploding household debt, a massive transfer of private debt to the sovereign in 2008, falling GDP, rising unemployment, and so on. Despite these events, Ireland is growing again. How can it be, Kinsella asked, that both Ireland and Greece engaged in broad-based austerity, and Ireland grew but Greece did not?

The explanation for Ireland’s resurgence is not to be found in its precrisis fiscal policy, he observed, as this sheds little light on the country’s fiscal health following the crisis (in 2006, Ireland’s net debt-to-GDP ratio was 24 percent). He explained that Ireland, with a GDP of €175 billion, was a relatively small country that, in effect, assumed the assets and liabilities of a banking system worth around €400 billion, and suffered the consequences thereof. Ireland’s response to the crisis, Kinsella offered, holds a number of lessons.

In the midst of massive consolidation, Ireland maintained most of its social protection system; it also has a very progressive income tax system. One of the main contributions of the government was to retain, throughout the crisis, roughly the same level of expenditure on social protection. Thus, the reduction in income inequality came from wealthier groups taxed under a relatively progressive system, which also served to reduce social tensions somewhat. Further, the people most likely to riot were not in Ireland. Kinsella explained that export-led growth has been Ireland’s model since the 1950s: Ireland exports its people, mainly younger workers. Ireland also experienced a sharp increase in productivity following the crisis, partly as a result of introducing more flexible work practices rather than cutting wages. Kinsella noted that wages, apart from the public sector, are actually relatively sticky in the Irish case, even though unit labor costs have fallen.

The share of the Irish economy that relies on exports was also an important factor in Ireland's unusual recovery. Kinsella explained that Ireland, Luxemburg, Hong Kong, and Singapore have more than 100 percent of their GDP in exports. Countries with more than 90 percent of their GDP in exports include Hungary, the Maldives, Slovakia, the UAE, and the Seychelles. These are the countries where austerity is feasible, he suggested, because their export sectors are big enough that the rest of the world can accommodate such shocks. Ireland experienced just such a dramatic shock in 2010: the banks were bailed out, and the rest of the world essentially accommodated Ireland during that shock. Kinsella argued that Ireland's massive open sector is what actually allowed this accommodation to occur.

In terms of relative openness, Ireland far exceeds Greece and Portugal. In contrast, any country in the eurozone that does not have a massive multinational presence the way Ireland does, and imposes wage cuts in a situation of ever-decreasing nominal demand, will experience decline. Using the International Chamber of Commerce Open Markets Index, Kinsella illustrated how openness is the key variable to determine whether an austerity policy is going to work. He noted that none of these facts were taken into account in the discussion about what to do in regard to Portugal, Spain, and Greece following the initial crisis.

In conclusion, the structure of the Irish economy today, particularly with respect to its multinational presence, is anomalous. Thus, one-size-fits-all policies just do not work, and Greece is an excellent example of that. Kinsella also noted that Ireland paid lip service to a lot of structural reforms but, in reality, it implemented very few of them. Ireland fixed the fiscal situation and the banks, but it did relatively little in terms of structural reform. Kinsella concluded that one-size-fits-all policies do not work, and that target-driven policies—particularly with respect to small, open economies—actually provide more, not less, uncertainty.

SESSION 7

The Ongoing Greek Crisis: What Is to Be Done?



Suzanne Daley, Giorgos Argitis, Dimitri B. Papadimitriou, Panagiotis Liargovas

MODERATOR:

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The New York Times

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ARGITIS observed that the recent developments in Greek economy lead one to question the current policy strategy, especially in terms of the labor market. He noted that in 2010 and 2011 many argued that Greece's was debt sustainable. Today, the same arguments are being made. However, an analysis conducted by the Institute of Labour (INE) shows that Greece's debt is not sustainable, and that there are better alternatives for resolving the debt crisis.

Using the work of Distinguished Scholar Hyman P. Minsky as the basis of his analytical framework, Argitis described four solvency states for a government. Ultra-Ponzi is the weakest state; the government is dependent on the markets to finance its debt obligations and refinance its current liabilities, and there is high credit risk and risk of default. Ponzi is the second solvency state, with relatively lower credit risk; there is a primary surplus that is smaller than the interest payments on the accumulated debt. This forces the government to capitalize part of the interest payments, thus

increasing its debt and also increasing its credit risk. In a speculative state, the primary surplus covers interest and potentially part of the maturing debt; credit risk is low and depends on the monetary and macroeconomic environment of the economy. The level of solvency risk does not prevent refinancing maturing debt. Hedge status is the most stable of the four solvency states, with no risk associated with refinancing.

Argitis next presented an analysis of the solvency of the Greek government carried out by the INE. The analysis showed that the government was in an ultra-Ponzi state between 2009 and the end of 2013. He noted that, assuming Greece achieves the required primary surpluses under the second bailout agreement—and it is unclear if this is realistic—there is an expectation for surpluses of 3.5 percent or 4.5 percent of GDP up until 2020. If we assume that Greece achieves this target, and given its current progress in terms of debt obligations, the country could reach the lower limit of speculative status. Argitis cautioned that this scenario is based strictly on theoretical analysis. He noted that a recent forecast by the International Monetary Fund of the growth rates needed for Greece to achieve primary surpluses in the medium term requires a growth rate of approximately 5.5 percent through 2020; however, for Greece to achieve solvency, it will need to attain a growth rate of roughly 7 percent. In other words, Greece would have to grow at a rate similar to China to achieve a primary surplus without any fiscal adjustment. He suggested that this seems to be the hidden assumption of the troika—additional rounds of financing support scheme will require additional fiscal adjustment and internal devaluation. Argitis argued that analyzing the solvency of the government sector based on interest and surpluses serves as a better basis for developing debt-management options.

He presented two scenarios to reduce Greece's debt obligations and interest payments by 30 percent and 50 percent, respectively. If Greece's debt obligations and interest were reduced by 50 percent, the [required] growth rate would fall by roughly 2 percent. At this level, the solvency of the economy and sustainability of the debt would be restored and the public sector would shift into speculative status; while if interest payments are reduced to 50 percent, it can even move into the hedge status.

This analysis reveals the significant lack of realism in the current debate on how to handle the Greek debt crisis. It shows that Greece's level of debt is unsustainable, and that additional borrowing and austerity will undermine, not repair, the Greek economy. It also shows the direction that realistic economic policy should take for Greece to exit the debt trap, particularly in terms of servicing the debt and interest payments. However, Argitis noted, if there are additional bailouts, these will likely require changes in the labor market, social security system, and fiscal system, further undermining the economic, social, and political stability of Greece.

He next outlined the INE's proposal for managing Greece's debt. The proposal aims to (1) reconfigure Greece's debt obligations on the basis of a sustainable primary surplus and sustainable public debt; (2) implement a public employment guarantee program; and (3) reregulate the labor market, to provide greater protections for "informal" employees and strengthen collective bargaining. INE also suggests restructuring the tax system to vary business taxes based on firms' adoption of these three reforms.

Argitis concluded that if implemented, the proposal would generate the resources needed to fulfill Greece's debt obligations in a sustainable manner while promoting social stability and national dignity—without undermining the stability of the eurozone.

LIARGOVAS echoed the observation that there has been a lack of realism regarding Greece's debt and the assumptions made regarding its sustainability, specifically in the area of primary surpluses. He began

with a discussion of the results of past fiscal adjustment policies to better understand this lack of realism. He offered an overview of a number of methodological issues pertaining to forecasts, program implementation, and related issues. He noted that it was not his goal to offer a definitive assessment of the success or failure of fiscal adjustment policies. However, he added, it is difficult to ignore the overall effects of the policies implemented in recent years.

Among the impacts of austerity, Liargovas noted that Greece's output has fallen 26.9 percent compared to 2008; unemployment stands at approximately 27 percent; and poverty has risen to nearly 36 percent. However, austerity was not limited to Greece: it was implemented in a number of other countries as well. Clearly, there is something different about Greece's experience under austerity compared to other countries (e.g., Ireland, Portugal, and Cyprus) that implemented fiscal adjustment programs during the same period. Liargovas suggested that instead of clearing away debt and opening a path to growth, countries suffered in proportion to the depth of the austerity policies they imposed—Greece most of all. He then turned to a discussion of some of the specific forces that undermined the Greek recovery under austerity.

Liargovas noted that Greece had embraced austerity previously but it had never done so in the presence of such a deep recession. For example, during the 1990s Greece undertook debt reduction measures, but because of positive expectations for growth (under the euro), the economy grew. In 2010, the expectations for the Greek economy were precisely the reverse—so debt reduction led to uncertainty, and consumption and investment declined.

The mixture of the policies implemented also played a role. Many contended that reduced public spending would lead to economic growth. However, the spending cuts that Greece implemented were then followed by tax increases. Corruption and the continued influence of groups seeking to protect their economic interests undercut many debt-reduction efforts, and explain the emphasis on taxation rather than spending cuts. Reductions in public spending, Liargovas noted, affect corrupt interests, so tax increases were pursued—regardless of the negative impact on the economy and society.

The role of domestic and international institutions is another important dimension in the Greek crisis. A recent study showed that the protracted crisis in Greece was due in part to the weakness of institutions and weak governance compared to Cyprus. For example, the lack of a stable, effective tax system was an obstacle to efficient tax collection. Similar observations could be made regarding the labor and goods markets. Further, Liargovas argued that European institutions were not ready to tackle the crisis, as the euro-area governance framework is still evolving and as a result its responses were too little too late.

Turning to the question of the fairness of the adjustment program, it is clear that the levels of long-term unemployment, poverty, and poverty risk are so high as to fail any test of fairness. Citing examples of fiscal adjustment in Sweden and Finland, he observed that when a fiscal adjustment program is fair (i.e., if vulnerable populations are protected), the efficiency of the program is greater. Greece's policies do not fare well when measured against this standard.

The last factor that has undermined the Greek recovery is exports. In 2011–13, Greek exports increased 1.5 percent, while Spain and Portugal increased their exports 8 percent and 10.3 percent, respectively. Liargovas suggested that if some or all of the preceding impediments to the Greek recovery had been removed, Greece might also have seen an increase in its exports. But in the presence of so many obstacles, exports have contributed little to the country's recovery.

Though Greece reported a positive growth rate in 2012, Liargovas cautioned that it is unclear if it is sustainable. There are a number of near-term threats to the recovery. He argued that for growth to take root, Greece requires debt relief. Debt is not simply a Greek issue, he stated, it is a European issue, as there are other countries with debt higher than 100 percent of GDP. The sustainability of growth also depends on the quality and continuity of various reform initiatives, as discussed above. Political stability is another important element, and there is also the possibility of external shocks, which can impede policy efforts. Liargovas noted that European history offers many examples of disruptive shocks. Finally, he concluded, there is the broader question of whether the Greek recovery is an isolated problem or part of a wider European problem of competitiveness and fiscal governance.

Contrary to a recent wave of optimism in some quarters, **PAPADIMITRIOU** argued that Greece is not headed for a recovery. Critiquing recent claims of an economic turnaround, he offered a range of statistics demonstrating that the troika's optimism is unfounded. For example, real GDP has fallen to 2001 levels (24 percent lower than its prerecession peak), effectively wiping out all of the economic gains of more than a decade. Nominal wages have decreased by 24.8 percent and real wages have decreased 28.7 percent since the 2010 peak. Likewise, unit labor costs for Greece have dropped by 16 percent, and are now close to Germany's unit labor costs. In terms of employment, more than one million jobs have been lost since the beginning of the crisis and there are rising trends in migration and long-term unemployment. Greece has also seen a dramatic increase in poverty.

Turning to the components of GDP, Papadimitriou noted that exports have been the major determinant of a recovery in output but are thus far insufficient to offset the declines in consumption. Private investment in manufacturing and construction has also declined. Greece's financial balances show that the government deficit has been decreasing steadily, and the current account has certainly been improving. However, despite the enormous amount of aid given to the financial sector there has been little progress in terms of increasing output or employment. Household deleveraging continues at a significant pace. There is a significant volume of nonperforming loans—roughly \$95 billion yet to be resolved.

In terms of the Greek government's receipts, social security contributions have been declining, because employment is much lower. In contrast, taxes on income and wealth seem to have remained stable. But considered in terms of the roughly 30 percent drop in income since the onset of the crisis, this actually indicates a relative increase in taxes. Government expenditures have been decreasing, mostly as a result of reduced social benefits such as unemployment insurance. Papadimitriou noted that given the increasing levels of unemployment, this trend is going in the wrong direction. Overall, he argued that the data offer little indication of recovery.

He then turned to the results of simulations based on the Levy Institute's stock-flow consistent macroeconomic model to examine the trajectories of Greece's financial balances for the next three years. He first presented a baseline scenario that shows that the government deficit will under no circumstances approach a 4.5 percent surplus, and is therefore insufficient to service Greece's debt. While there is an improvement in the current account and the private sector, the baseline results show only a modest growth rate, far too small to absorb the number of unemployed. The baseline scenario is therefore a jobless recovery—a huge shortfall in terms of jobs, and very anemic growth.

The first of the three alternative policy scenarios is a new "New Deal" for Greece. In this scenario, Greece would receive a transfer, funded by the European Union, of €19.8 billion over three years, at the

rate of €1,650 million per quarter. These funds could be spent for additional public consumption and targeted investment to promote growth in the production of goods and services, some of which would be destined for export. Alternatively, these funds could be used for a direct public job creation program covering at least 300,000 unemployed workers.

Under the second scenario, interest payments to public sector investors would be suspended and the public debt frozen until 2010 GDP levels were restored. The scenario assumes that payments to public investors such as the European Central Bank, estimated at €4 billion of the total interest payments owed, would be suspended, while private sector investors would continue to be paid. Finally, the third scenario combines scenarios 1 and 2.

Papadimitriou explained that the largest improvements in unemployment occur under the combined scenario. However, these results do not include a direct job creation program; total employment growth would be much stronger if it did.

In terms of the real GDP growth rate, the baseline scenario projects that for 2014 it would be 0.5 percent, reaching 1.93 percent in 2017. Under the combined scenario, Greece would achieve a 2.21 growth rate by 2017.

Under the baseline scenario Greece shows a nearly balanced budget by 2017–18, including debt payments. However, this is not much of a recovery, since unemployment would remain very high and growth rates would remain quite low. In contrast, under the combined scenario Greece shows a 5.7 percent surplus by 2017–18. There are also significant differences in terms of the current account balances under each of the scenarios. Under the baseline scenario Greece has a €6.5 billion surplus, and €13.4 billion under the combined scenario.

On the question of whether these policy alternatives are feasible, Papadimitriou was unequivocal: there is no question that they are plausible. One need only recall Germany under the Marshall Plan. Germany received both a loan (never repaid) and a gigantic debt write-off—over 100 percent of GDP—and a suspension of interest payments on the remainder. In conclusion, Papadimitriou paraphrased Minsky's view that the German theology of small and efficient government is a foolish illusion.

Participants



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Rania Antonopoulos is the macroeconomic policy adviser to the United Nations Entity on Gender Equality and the Empowerment of Women (UN Women). Prior to being appointed to her current post, she served as a senior scholar and director of the Gender Equality and the Economy program at the Levy Economics Institute of Bard College; taught economics at New York University; and served as a consultant and adviser for the United Nations Development Programme (UNDP), International Labour Organization (ILO), and other UN entities. Antonopoulos's areas of expertise are gender and macroeconomic policy, pro-poor development, and social protection. During her tenure at the Levy Institute, she directed policy-oriented research projects on South Africa, India, and Mexico, identifying the macro-micro impacts of employment guarantee programs that particularly benefit women. Since 2011, she has collaborated with the Labour Institute of the General Confederation of Greek Workers on a public service job creation program that was adopted by the Ministry of Labour and put into effect in 2012. Building on that experience, she proposed a fully developed job guarantee proposal for Greece, leading a team of researchers that has received significant policy attention. In 2011, she also codirected a joint project of the Levy Institute, UNDP, and ILO that fully integrates women's unpaid work in official poverty measures, with case studies for Mexico, Chile, and Argentina. Her latest publications include *The "Great Recession": Gender Perspectives and Gender Impacts of the Global Economic Crisis* (ed.; Routledge, 2013); "Explaining Long-Term Exchange Rate Behavior in the United States and Japan," in J. K. Moudud, C. Bina, and P. L. Mason, eds., *Alternative Theories of Competition: Challenges to the Orthodoxy* (Routledge, 2012); *Unpaid Work and the Economy: Poverty, Time Use and Gender in Developing Countries* (ed.; Palgrave Macmillan, 2010); and *An Alternative Theory of Long-run Exchange Rate Determination* (VDM Verlag, 2009). Antonopoulos holds a Ph.D. in economics from The New School for Social Research.

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Emilios Avgouleas is the inaugural holder of the International Banking Law and Finance chair at the University of Edinburgh. He is also the head of the Commercial Law program at Edinburgh Law School and director of the Edinburgh LLM in International Banking Law and Finance. Avgouleas is an acknowledged expert on financial market regulation, banking law and finance, and global economic governance. He has published extensively in the wider field of international and European finance law and economics and behavioral finance with leading journals. He is also the author of two acclaimed monographs: *Governance of Global Financial Markets: The Law, the Economics, the Politics* (Cambridge University Press, 2012) and *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis* (Oxford University Press, 2005). He is the coauthor, with Sir Ross Cranston, of the next edition of *Principles of Banking Law* (Oxford University Press, forthcoming). His latest article (coauthored with C. Goodhart) is on bank bail-ins. Avgouleas has been a visiting professor at a number of universities, including Duke University, Hong Kong University, Shanghai Jiao Tong University, and Ludwig Maximilians University Munich. His work was recently described as “paradigm shifting” by the *Financial Times* and has been cited widely, including in financial market policy reports and impact studies of leading policymaking bodies.

Avgouleas is also a qualified lawyer with many years of practice in the field of global markets. He has practiced extensively in the broader field of international financial law and structured finance and has worked in senior posts with leading global law firms. He has advised governments, development organizations, and central banks on issues ranging from bank rescues to sovereign debt restructuring and financial stability, and also on issues of economic development and market integrity. He currently works with United Nations bodies on issues of ethical finance and long-term economic growth and is a member of the Financial Markets Law Committee working group (operating under the auspices of the Bank of England) examining issues surrounding the latest Argentinian bankruptcy. A graduate of Athens Law School, Avgouleas conducted his postgraduate at the London School of Economics, from which he obtained a Ph.D. in law and economics and an LLM in banking and finance law.

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Elga Bartsch is Morgan Stanley’s chief European economist. The main focus of her research is the euro area, especially the monetary policy of the European Central Bank (ECB). She is also a member of the ECB Shadow Council. In addition, she covers some core European countries, primarily Germany, the

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Marek Belka is governor of the National Bank of Poland. Born in 1952, Belka specializes in applied economics and contemporary economic thought. He has served as, among others, Deputy Prime Minister, Minister of Finance (twice), and Prime Minister of the Republic of Poland. He has worked as chairman of the Council for International Coordination for Iraq, as director of economic policy for the Coalition Provisional Authority, and as executive secretary of the Economic Commission for Europe. Before he was appointed head of Poland's central bank in June 2010, he was director of the European department at the International Monetary Fund.

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Peter Bofinger is a full professor of economics at the University of Würzburg. Since March 2004, he has also been a member of the German Council of Economic Advisers (GCEA). He was appointed to a third five-year term in March 2014. Bofinger began his career in 1978 as an economist at the GCEA before moving on in 1981 to become a lecturer at the University of Saarbrücken. Between 1984 and 1990, he was an economist with the Deutsche Bundesbank. He has also been a visiting scholar at the International Monetary Fund and at the Federal Reserve Bank of St. Louis. From 2003 until 2004, Bofinger was first vice president of the University of Würzburg. He has written books on economics and monetary economics and has worked as an adviser for European and international institutions. His main fields of research are European integration and monetary and exchange rate economics.

NIKOS CHRYSOLORAS

Nikos Chrysoloras is Greece and Cyprus bureau chief for Bloomberg News, based in Athens. Before joining one of the world's largest newsgathering operations, he was a Brussels-based EU correspondent and commentator for *Kathimerini*, Greece's newspaper of record, and a research associate at the Hellenic Foundation for European and Foreign Policy (ELIAMEP). In 2012, he won the Commentator Award at the European Press Prizes, while his articles on the euro-area debt crisis have been carried in several publications across Europe, including the *Guardian*, *El Mundo*, and *Publico*. Born in 1980, Chrysoloras grew up on the island of Serifos, Greece, and has lived in Syros, Athens, Aberystwyth, Colchester, London, and Brussels. He holds a Ph.D. in government from the London School of Economics and a master's degree in political theory from the University of Essex.

SUZANNE DALEY

Suzanne Daley became a foreign correspondent covering Europe for *The New York Times* in March 2010. Previously, she was the national editor of the *Times*, taking over just weeks after Hurricane Katrina flattened New Orleans in 2005. During her tenure, the national desk covered events ranging from the massacre at Virginia Tech to the collapse of the Minneapolis bridge, and won a Pulitzer for the series “The DNA Age,” which chronicled how the study of genetics was changing life for average Americans. Before taking over the national desk, Daley was named education editor in 2002. In 2004, she was also given responsibility for the coverage of social trends like those in child rearing, religion, and technology’s impacts, and was part of the team that planned the new Thursday Styles section of the newspaper the following year. Before that, Daley was chief of the Paris bureau from August 1999 to July 2002, and served as bureau chief in Johannesburg starting in June 1995, shortly after Nelson Mandela was elected president. She served as deputy metropolitan editor from September 1993 to June 1995, and was the first assistant metropolitan editor from November 1991 to September 1993, during which time the desk won a Pulitzer for its coverage of the first terrorist attack on the World Trade Center. She was metropolitan reporter from 1982 to 1991, covering topics ranging from foster care to City Hall and transportation. Daley joined the *Times* in June 1978 as a copy person. She worked her way up to news assistant in 1980 and was promoted to reporter in 1982. She holds a B.A. degree from Hampshire College.

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Yannis Dragasakis is MP for the Second Electoral District of Athens and deputy speaker of the Hellenic Parliament, and has been for many years a member of the Parliament’s Standing Committee on Economic Affairs and the implementation of the State Budget. He is a member of the Parliamentary Assembly of the Council of Europe and president of the Sub-Committee on the European Social Charter and Employment. He is also a member of the Central Committee of SYRIZA and the governing board of the Institute “N Poulantzas” (EPPNP). Dragasakis was born in Lasithi, eastern Crete, in 1947. He studied economics and political science in Greece and abroad. As a scholar and researcher in economics, he has worked in multiple offices and positions of responsibility in the private sector. As a student, he actively participated in the antidictatorship struggle and was secretary of the Greek Students’ Association of London. He was a leading member of the Communist Party of Greece (KKE) until 1991 and of the Coalition of the Left and Progress (SYNASPISMOS) since its establishment. In the Parliamentary elections of June 1989, he was elected MP for the Electoral District of Chania (SYNASPISMOS). He served as deputy minister of the national economy during the all-party coalition government of PM Xenophon Zolotas (November 1989 – April 1990). Dragasakis was elected MP for the Second Electoral District of

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Economics, Journal of Post Keynesian Economics, Metroeconomica, Review of Political Economy, and Structural Change and Economic Dynamics. Among his latest books are *The Demise of Finance-dominated Capitalism: Explaining the Financial and Economic Crises* (coeditor and author; Edward Elgar, forthcoming), *Distribution and Growth after Keynes: A Post-Keynesian Guide* (Edward Elgar, 2014), *The Macroeconomics of Finance-dominated Capitalism—And Its Crisis* (Edward Elgar, 2012), *A Modern Guide to Keynesian Macroeconomics and Economic Policies* (coeditor and author; Edward Elgar, 2011), and *The World Economy in Crisis—The Return of Keynesianism?* (coeditor and author; Metropolis, 2010).

STUART HOLLAND

Stuart Holland formerly was a Member of the House of Commons, Shadow Financial Secretary to the UK Treasury, and Shadow Minister for Development Cooperation. In his 20s he was personal adviser on European affairs to UK Prime Minister Harold Wilson. Holland authored the case for a New Messina Conference that was endorsed by Andreas Papandreu and François Mitterrand and led to the commitment to economic and social cohesion in the Single European Act of 1986, which, since the onset of the eurozone crisis, has been serially breached. In a 1993 report to Jacques Delors, Holland proposed Union Bonds to offset the deflationary effects of the Maastricht debt and deficit criteria, and has been active in the recent debate on eurobonds. In 1997, António Guterres gained acceptance by the European Council of Holland's recommendation that the terms of reference of the European Investment Bank (EIB) should include investments in health, education, urban renewal, and the environment, as well as green technology and innovation. His recent eBook *Europe in Question—and What to Do About It* stresses both that borrowing from the EIB does not count toward national debt, which gives Europe the equivalent of US Treasury bonds without needing a common fiscal policy, and that eurobonds issued by the European Investment Fund could attract global surpluses to cofinance the investment-led recovery program that Jean-Claude Juncker has made the first of his program priorities as president of the Commission.

PATRICK HONOHAN

Patrick Honohan is the 10th governor of the Central Bank of Ireland and was appointed on September 26, 2009. From 2007 until his appointment as governor, he was professor of international financial economics and development at Trinity College Dublin. Prior to this, Honohan spent almost a decade at the World Bank, where he was senior adviser on financial sector policy. He was previously a research professor with the Economic and Social Research Institute (ESRI), Dublin (1990–98), economic adviser to Irish Prime Minister Garret Fitzgerald (1981–82 and 1984–86), and an economist at the Central Bank of Ireland (1976–81 and 1984–86) and the International Monetary Fund (1971–73). In his career in the Irish public service and at the ESRI he contributed policy advice directly and indirectly to successive Irish governments. During his time at the World Bank, Honohan's work entailed the provision of policy advice to central banks and governments around the world. He also played a key role in the design and implementation of the IMF/World Bank Financial Sector Assessment Program, as applied to developing countries from its initiation in 1999. A graduate of University College Dublin, he received his Ph.D. in economics from the London School of Economics (LSE) in 1978. He has taught economics at the LSE and at the University of California–San Diego, the Australian National University, and University College Dublin, as well as at Trinity College. In recent years, his research has focused mainly on monetary and financial sector policy.

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Jan Kregel is a senior scholar at the Levy Economics Institute of Bard College and director of its Monetary Policy and Financial Structure program. He also holds the position of professor of development finance in the Ragner Nurkse School of Innovation and Governance at Tallinn University of Technology and distinguished research professor at the University of Missouri–Kansas City. He is editor of the *Post Keynesian Economics Forum* and coeditor of the *Journal of Post Keynesian Economics*. In 2009, Kregel served as Rapporteur of the President of the UN General Assembly's Commission on Reform of the International Financial System. He previously directed the Policy Analysis and Development Branch of the UN Financing for Development Office. He is a life fellow of the Royal Economic Society (UK) and an elected member of the Società Italiana degli Economisti and patron of the Associação Keynesiana Brasileira. In 2010, Kregel was awarded the prestigious Veblen-Commons Award by the Association for Evolutionary Economics; in 2011, he was elected to the Italian Accademia Nazionale dei Lincei.

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LUBOMÍR LÍZAL

Lubomír Lízal was appointed to the board of the Czech National Bank by the President of the Czech Republic in February 2011. He serves on the governing board of the Dynamics of Institutions and Markets in Europe research network, the Scientific Council of the Faculty of Economics at the University of Economics in Prague, the Czech Statistical Council of the Czech Statistical Office, and other scientific boards. He was a member of the expert team that prepared the Ministry of the Environment National Allocation Plan for 2008–12. From August 2010 to February 2011, Lízal served on the National Economic Council of the Government, and from November 2010 to February 2011 was a member of the supervisory board of the energy company EZ.

Lízal was born in Prague in 1969 and graduated in systems programming from the Faculty of Electrical Engineering at the Czech Technical University. In 1998 he obtained a Ph.D. in economics at the Center for Economic Research and Graduate Education (CERGE) at Charles University, where he was appointed associate professor of economics in 2006. He has been a senior researcher at the Economics Institute of the Czech Academy of Sciences (EI) since 2009. In 2002–03 Lízal served as deputy director for research, and in 2003–08 as director, of CERGE-EI, and from 2003 to 2013 was a member of the CERGE-EI executive and supervisory committee. He has held fellowships at the Tinbergen Institute, Amsterdam (1992), the University of Pittsburgh (1994–95), and the William Davidson Institute at the University of Michigan (1996–97 and 2000–01). In 1994 and 2000, he worked as an outside consultant for the World Bank. In his research Lízal specializes in the economics of transition, econometrics, applied microeconomics, market structures, corporate governance, competitiveness, monopolies, and the relationship between economics and the environment. He is the author or coauthor of many articles in reviewed and impact journals as well as chapters in books (mostly in English). He regularly reviews articles for international impact factor journals and proposals for grant agencies, and since 2003 has been the local coordinator for the *World Competitiveness Yearbook*, issued by the leading Swiss management institute IMD.

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