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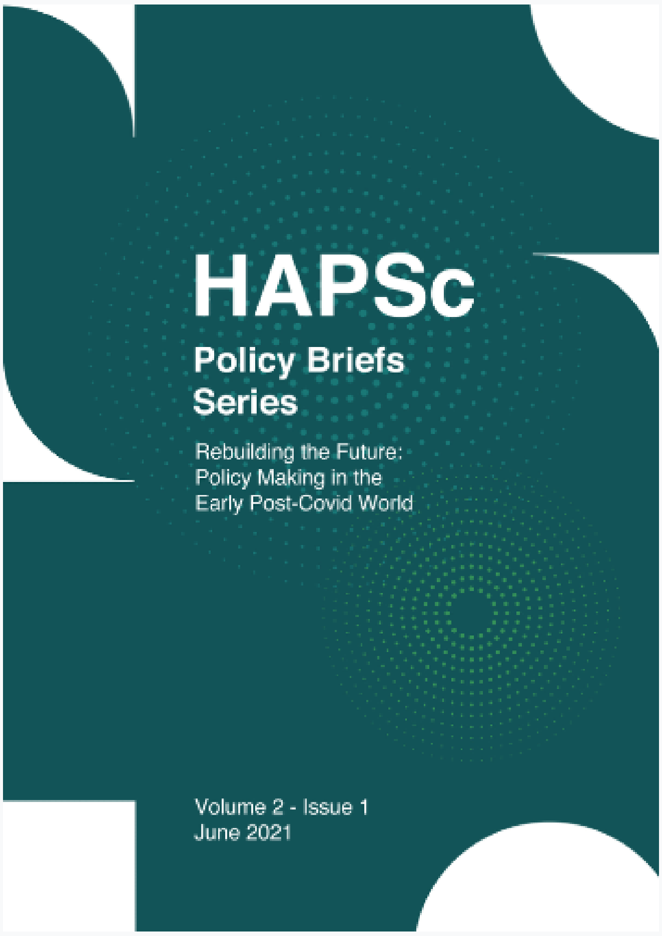

Post-Pandemic Recovery and Sustainable Growth in the EU: A Post-Keynesian Approach

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Post-Pandemic Recovery and Sustainable Growth in the EU: A Post-Keynesian Approach[1]

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Abstract

Once again, the EMU faces an economic crisis, this time caused by the Covid-19 pandemic. To avoid the mistakes of the insufficient response to the global financial crisis, it is vital that this time the focus will turn on achieving fast, sustainable recovery, instead of contractionary measures that would hinder recovery and long-term growth. This paper briefly presents the basic elements of the Post-Keynesian / Post-Kaleckian framework of analysis for the economic regimes. The concept of the wage-led and profit-led regimes is addressed, based on which it can be assessed what kind of policies are needed in an economy to promote sustainable, long-term growth. As the relevant literature finds that the Euro Area as a whole and most of the Eurozone members are wage-led, it is concluded that the EU needs to design and implement policies that will strengthen the labor share and address the long-standing problem of unemployment. Given the need to counter climate change, the proposed policies should be coordinated and used as tool to achieve the goals set by the European Green Deal.

Keywords: Economic Regimes; Functional Income Distribution; Sustainable Growth; Post-Pandemic Recovery; European Union; European New Deal; Post-Keynesian Growth Models

Introduction

The Covid-19 pandemic has changed drastically, at least for the time being, the approach that dominates mainstream economic thought concerning the role and the importance of the state in the economy. Back in the global financial crisis, a "silent consensus" for the inefficiency of the financial sector to self-regulate led to quantitative easing (QE) programs by the central banks – a "non-standard monetary policy". This solution was promoted as another problematic hypothesis of the mainstream economic thought – the underestimation of the links between the financial sector and the real economy – became too dangerous to ignore any longer, with a series of bankruptcies ready to unravel in a domino effect. Moreover, the excessive inflation that critics feared would be caused by the QE programs was never realized, showcasing the narrow (and, ultimately, inaccurate) way that mainstream economic theory perceives of the mechanisms of inflation. Yet, unlike in 1929 when the Great Depression led to Roosevelt's "New Deal", the prevailing economic doctrine was not overturned, as was particularly shown in the EU through the "Five Presidents' Report" and the

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Economic Adjustment Programs that problematic economies were forced to implement (Reissl & Stockhammer, 2016).

It took an even greater shock, that of the pandemic and its economic consequences, for even the most conservative policymakers to openly recognize the limits of "self-regulated" markets (at least at a policymaking level). Governments stepped in to protect jobs and businesses, substantially increasing their expenditures. The welfare state – that has been accused the last decades of being overly expensive and inefficient, and in many cases has been severely weakened by "fiscal adjustments" – stands out once again as a vital aspect of the modern economies, especially during a crisis (Tzagkarakis et al., 2020).

In the new economic reality that has been forged by the pandemic, EU leaders and EU Institutions have a historical chance to "escape from the habits of thought" that have led to a series of economic deadlocks in most of the capitalist economies throughout the world over the last fifteen years.[3] As Stockhammer (2021) emphasizes, the secular stagnation that followed the global financial crisis shows the long-lasting effects of a demand shock, making the fiscal policy a vital and effective tool to deal with such a crisis. Calls for a "European New Deal" have been intensified, and such a radical shift to the orientation of the economic policies could not help but include an agenda for the green transformation of the European economies. This policy brief aims to present a Post-Keynesian / Post-Kaleckian framework on which the recovery of the European Union can be built upon, and how instrumental it is for a successful transition to sustainable, all inclusive, growth.

1. Economic Regimes and Functional Income Distribution

The policies needed to design a sustainable, long-term growth strategy, depend on the overall economic regime of an economy. As Lavoie & Stockhammer (2013) explain, if an increase in the profit share has expansionary effects on the overall economy, the economy is profit-led. On the contrary, if it is an increase in the wage share that creates expansionary effects on the economy, the economy is wage-led. It becomes apparent that the design of a growth strategy requires a deep understanding of the characteristics of the economy in question, as the wrong orientation of the policies implemented can have adverse effects: an increase in the profit share at a wage-led economy, as well as an increase in the wage share at a profit-led economy, will have contractionary effects and hinder growth.

[3] Keynes (2018/1936: vii) refers to *The General Theory of Employment, Interest and Money* as the result of his struggle to escape from "*...habitual modes of thought and expression*" that classical economics education had wrongfully impose on economists.

To identify whether the economic regime of a country is wage or profit-led, researchers examine what the effect of an increase (or decrease) in the wages will be on the aggregate demand, and therefore its components (consumption, investments, public expenditure and net exports).

Functional Income Distribution and the Decline of the Labor Share

It is obvious that examining the functional income distribution is vital in this framework of analysis, as it can provide useful insights on inequality and the overall economic performance of most advanced capitalist economies, especially after the global financial crisis. The downward trend of the labor share since the neoliberal era begun has been observed by various studies (IMF, 2007; OECD 2012; ILO, 2013; OECD, 2015).

Before we examine the role of government policies on functional income distribution, it is important to note that there is an inherent trend for the wage share to decline, due to the architecture of the contemporary international capitalist system. Stockhammer (2013) summarizes the main reasons behind the tendency for the wage share to fall. To begin with, technological change is pushing the wages of unskilled workers downwards, and it even causes unemployment to rise. For mainstream economists this is the main reason for the decline of the labor share internationally, since inequality can be attributed to technological change without the need for deeper investigation of its causes. Even in a broader and more realistic analysis of inequality, however, technological change is undoubtedly one of the contributory factors.

Moreover, globalization has been heavily debated regarding its role in the rising inequality and the suppression of the labor share. Stockhammer (2013) briefly presents the two main approaches: the Classical Trade Theory and the Political Economy of Trade approach. The first one stems from the Stolper–Samuelson theorem (Solper & Samuelson, 1941), which predicts that in advanced economies, international trade favors capital and might hurt the wages, while in developing economies it will benefit the workers. Although popular in mainstream economics, the empirical evidence does not support this theory. As Stockhammer (2013: 46) notes *"While workers in the North have been hurt, it is doubtful whether workers in the South have benefited. There is limited research on the effect of globalization on functional income distribution in the South, but there is a substantial body of evidence that inequality has increased in developing economies as a result of globalization"*. On the other hand, the Political Economy of Trade approach focuses on the effect that trade has on the bargaining position of capital and workers. As Rodrik (1997) explains, the liberalization of trade benefits capital (as the most mobile factor) and its bargaining power, pushing wages downwards. A

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series of studies have found negative effects of intensified trade on the wage share in both developed and developing countries.[4]

Last but not least, the process of financialization has altered fundamentally the capitalist system over the last decades. Epstein (2005: 3) defines financialization as *"[...] the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies*". According to Stockhammer (2013), financialization has favored the bargaining power of the capital against the workers heavily, due to the unrestricted movement of capital and the variety of choices to invest in financial products, as well as the shift of firms' strategy to short-term high profit, in order for the managers to satisfy the shareholders. Financialization has played a crucial role in the decrease of productive investments in the real economy, and its consequences to the effective demand. As far as the functional income distribution is concerned, the rapid increase in financial income has resulted in the further shrinkage of the wage share (Stockhammer, 2013; Hein, 2015; Kohler et al., 2019).

Pro-Capital versus Pro-Labor Distributional Policies

Given the aforementioned tendency for the labor share to decline, the distribution of income between capital and labor ultimately rests upon the mixture of policies implemented. Pro-capital policies entail the "liberalization" of the labor market by weakening collective bargaining institutions and reducing (or even abolishing) minimum wage, as well as a tax system "friendly" to capital gains and corporate income. These policies are designed to impose wage moderation, and decrease the wage share in the long-run. On the other hand, pro-labor policies aim to maintain or even increase the wages in the long-run, through strong labor market institutions and a more extensive welfare state (Lavoie & Stockhammer, 2013).

As mentioned before, it becomes apparent that in the context of the Post-Keynesian / Post-Kaleckian framework, designing public policies should be based on the features of the economy and not on ideological doctrines, as the "one size fits all" approach has proven devastating time and time again. Lavoie & Stockhammer (2013) concisely categorize the four possible scenarios concerning the match between the economic regimes and the distributional policies: Pro-capital policies in a profit-led economy would lead to profit-led growth, as the conservative concept of "trickle-down economics" predicts. The authors call this scenario "neoliberalism in theory". On the contrary, pro-capital policies in a wage-led economy would lead to stagnation or unstable growth dependent on exports or the

[4] See, for example, Harrison (2002) and Jayadev (2007).

accumulation of debt (export-led or debt-led growth – "neoliberalism in practice"). On the other hand, the implementation of pro-labor policies in a wage-led economy can lead to sustainable, long-term growth, a scenario labeled as "social Keynesianism" inspired by the Golden Age of Capitalism in the post-World War era. Finally, pro-labor policies in a profit-led economy could lead to stagnation and are doomed to be abandoned ("doomed social reforms").[5]

Empirical Studies on EU Economic Regimes

Bhaduri & Marglin (1990) worked on a concise model that allows for the empirical examination of the impact of a change in the functional income distribution on growth. The Bhaduri / Marglin model has sparked numerous empirical researches that examine the economic regime of countries, and some of them are presented below, focusing on the EU and its member-states.

Onaran & Galanis (2013) focus their analysis on the G20 countries and the Euro Area. They conclude that the Euro Area as a whole is significantly wage-led, a result that agrees with Stckhammer et al. (2009). Moreover, the find Germany, France and Italy being wage-led as well. For Germany, there are various researches that conclude its wage-led status (Naastepad & Storm, 2007; Hein & Vogel, 2008; Stockhammer et al., 2011). Naastepad & Storm (2007) and Hein & Vogel (2008) also agree with the wage-led results for France.

2. A European (Green) New Deal

If we accept the Post-Keynesian / Post-Kaleckian framework of analysis as a realistic approach to examining the economy, there appears to be a need for quite radical reforms in the economic governance of the EU. Given the current architecture of the EU system in general and the Eurozone in particular, the European Central Bank needs to officially be transformed into an institution that will use its power to implement a new economic agenda. It has become apparent that the recovery from the current economic crisis and the prevention of future such crises demand active intervention at an EU level, since member-states alone cannot face these challenges (Katsigianni, 2020). The complete separation of the monetary and fiscal policy, a unique characteristic of the Eurozone (Bini Smaghi, 2011), has to be reconsidered in order for the necessary policies (deriving from this analysis) to be implemented. The economic integration of the EU should focus on the convergence of the economies in a growth-oriented manner, as austerity measures have broadened the gap among the member-states (Sbarouni et al., 2020). Alvarez et al. (2019) identify the need for a progressive reform

[5] As Lavoie & Stockhammer (2013) note, this scenario is associated with the neoliberal TINA ("there is no alternative") slogan, popularized by Margaret Thatcher and claiming that progressive policies are futile.

of the fiscal governance in the EMU with augmented coordination of the member-states in various aspects (economic, environmental, social policies), addressing the democratic deficit of the current system and promoting transparency. The asymmetry in the trade balances within the EU is also an important problem that needs to be addressed in a fair and expansionary way, for the successful and sustainable convergence of the European economies (Emmanouil-Kalos, 2020).

Europe suffers from high unemployment, and youth unemployment in particular (Pastone, 2018), and the pandemic has augmented the problem (Lambovska et al., 2021). Especially the South European member states that suffered the most from the Eurozone economic crisis, such as Greece for example, have a severe problem of youth unemployment (Kotroyannos et al., 2013; Kotroyannos et al., 2015; Tzagkarakis et al., 2021) that substantially hinders their growth prospects. Unfortunately, the dominant economic perspective isn't really concerned with it. For Post-Keynesians, full employment is a vital prerequisite of a truly liberal and functional capitalist economy. As there appears to be a need for the increase of the labor share for the aggregate demand to revive the economy, it is about time that policies that actively promote employment were implemented.

One of the most decisive and controversial policies (for mainstream economists) that the Post-Keynesian literature proposes, is the implementation of Employer of Last Resort (ELR) programs. Supported by the European Commission and financed by the ECB, ELR programs can be the solution to the persistent unemployment. Argitis & Koratzanis (2021) note that although the Short-Time-Working (STW) schemes during the pandemic were a positive response, they are not enough to combat unemployment at a fundamental level, as they neither create new jobs nor are they oriented towards long-term growth. As Anastasakis (2020) emphasizes, ELR programs can be oriented towards countering climate change, rendering them an important tool in the broader efforts for sustainable development. Of course, the design of such programs would have to be tailor-made to each country's needs, as the "one size fits all" has proved to be problematic.

The implementation of ELR programs can give a long-needed boost to the European economies, while also restore the faith of its citizens not only to the EU but also to the capitalist system itself. However, the creation of low-paying jobs through these programs is only a step towards sustainable growth. Public investments for green infrastructure and innovation are a key component for strengthening the private sector while at the same time addressing the environmental challenges of our times. The generation of flows of income towards the private sector by the public investments will not only boost aggregate demand, thus creating more jobs in the private sector, but it would also help stabilize the financial system by providing firms and households the resources to meet their debt obligations.

Conclusions

The economic architecture of the EU was based on a theoretical blueprint that stemmed from the dominant economic theory of the time. The international status quo at the time created the impression of a functional system, only for the global financial crisis to show the vulnerabilities and inefficiencies of said system. Due to its inflexible nature, the response of the Eurozone to the global financial crisis proved inadequate; although the Euro survived, the measures that were implemented severely hurt some economies, in greater degree that the crisis itself did. The pandemic offers the chance for reconsideration of the way the EU operates and legitimizes the radical reforms that are long overdue, for a sustainable economic integration in the EMU.

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