THE GLOBAL ECONOMIC CRISIS AND EMPLOYMENT POLITICAL REACTIONS – A COMPARISON BETWEEN CHINA AND EUROPE

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Abstract. The global economic crisis unfolded since 2008 at a surprising and accelerating speed. The crisis has serious implications for unemployment in China and in the European Union (EU). Important aspects of the crisis are: the collapse of global trade and world-wide over-capacities of industrial production. These developments call now for a renunciation of old beliefs in supply-side economics and for a new awareness of the great importance of maintaining an appropriate level of macroeconomic demand for output. Surprisingly, the Chinese authorities seem to be more ready than the EU authorities to follow such "Keynesian" policies in the wake of this crisis. There are several reasons for this difference.

(1) EU member countries have more "automatic stabilizers" than China due to their more extended systems of social protection in the case of unemployment.
(2) Some EU member countries (apart from Germany) are less exposed to the collapse of world trade than China. Therefore they do not have to compensate quite so much for the global decline in exports.
(3) Due to past economic political agenda setting, EU member countries are strongly committed to elaborate and formalized supply-side oriented economic political processes. An important relevant paradigm is the "Lisbon agenda" which hitherto shaped strongly their "economic political guidelines". The EU did react to the new crisis by implementing in 2009 a "European Economic Recovery Program" (EERP) with considerable commitment to "fiscal stimuli". But there is emphasis that the implementation of the EERP should be connected to the established "Lisbon agenda". Thus the EU has a particularly long lasting after-effect of the supply oriented convictions stemming from an old economic political scenario which was quite different from the present one.
(4) A further reason why economic political reactions to the global economic crisis differ between China and the EU might lie in different priorities concerning a new global financial system. Although China is also affected by the "toxic debts" coming mostly from financial firms which were treated too leniently due to influences from the USA and from Great Britain, it is rather the Europeans – and among them in particular the Germans – who press for a new system of global financial oversight. European reluctance to follow American pressure for more European "fiscal stimulus" could be seen as an attempt to motivate the USA to agree to establishing stricter financial oversight on a global level. The distant hope behind such manoeuvering of the Europeans could be that eventually a "World Financial Organisation" (WFO) might be set up parallel to the World Trade Organization (WTO).
    The main aim of China in the field of a global financial system reform is different: China has the specific problem of particularly large holdings of foreign currency reserves which are denominated in US-dollars. Due to worries about the future worth of the US-dollar denominated reserves, Bank of China Governor Zhou Xiaochan called in March 2009 for the replacement of the US-dollar as an international reserve currency by a new international financial instrument which could be similar to the "Special Drawing Rights (SDR) of the IMF.

The differences in response to the current crisis might perpetuate the crisis and lead to protracted unemployment problems because of a current lack of global economic political leadership. The USA were intent to lead the world into economic recovery by "stimulus packages" and China is the most important partner in this endeavour. The Keynesian multiplier effects of such demand effects are visible but there are doubts about the fiscal sustainability of maintaining such stimuli and about the viability of the old financial system. Unresolved leadership problems existed also at the time of the Great Depression of the last century and they seriously prolonged the economic downturn at that time. A clear consciousness of such leadership problems and a cooperative spirit in their resolution might be an important element in bringing about a lasting global economic recovery.

1. Introduction

The main topic of this contribution is unemployment, and this topic is a very urgent one in the wake of the present global economic crises. There is wide-spread consensus that in this situation the world-wide stimulation of macroeconomic demand is an appropriate and urgent remedy. But there are also dissenting voices about the necessity of stimulating demand, and we must take them seriously because the different opinions about the appropriate remedies for unemployment shape, of course, the different outcomes of international debates about the appropriate actions to be taken in the wake of the crisis of 2008/9.

Under a longer perspective there are at least *two* types of recurring sets of grave economic problems. The one is a combination of unemployment and deflation – a set of problems generally seen as particularly relevant in the wake of the financial crisis of 2008/9. But on the other hand there is an equally important set of problems set by the opposite of deflation, namely by *in*flation and by the disruption of economy and society which inflation can bring about. Economic history gives plenty of examples of the relevance of both of these type of problems.

As far as inflation in China's recent history is concerned, there is the widely accepted view that the victory of the communist movement in China in 1949 was – apart from a number of other reasons – to a considerable extent due to the economic hardship generated by the "Great Chinese Inflation" which in turn was caused by the Chiang Kai-shek regime in the previous years (**Ebeling**, 2004).[1] In almost prophetic anticipation of the lessons that might be drawn from the later events in the China of 1949, John Maynard Keynes claimed in 1919 already – 30 years before those events – that it was the Communist revolutionary W.I. Lenin who "is said to have declared that the best way to destroy the Capitalist System was to debauch the currency". **Keynes** (1919, ch.6) very much supported this view and declared that " Lenin was certainly right. There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency." But this was not to mean that Keynes was blind for the other set of problems, namely the ones which are associated with deflation. In fact, the name of Keynes became paradigmatic for economic political reactions to situations characterized by deflation and involuntary unemployment.

Germany is a good example for a country where both type of problems might be studied as having occurred within a very short time-span. Germany had a devastating hyperinflation, namely in the wake of World War I.(**Holtfrerich**, 1986). Some commentators of German history say that it was this hyperinflation in the early 1920ies that radicalized the middle classes and then led them to vote for the National Socialist ("Nazi") dictatorship in Germany in 1933. Other commentators point to the fact that the voting behaviour in the 1930ies was far more influenced by quite a different economic experience, namely by Germany's *deflation* ten years later in the wake of the Great Depression of the 1930ies (**Kindleberger**, 1973). The exorbitant unemployment that went with the Great Depression and with the inappropriate macroeconomic policies taken by the incumbent democratic German government at that time alienated the population from the

[1] For a very brief account see **Chow** (2002, pp.20-1): "Civil war with the Communists started [in 1945] and the government financed the war essentially by printing more money . . . That led to inflation and inflation was unpopular. . . . Hyperinflation occurred in 1948-9. . . . Government popularity hit an all-time low in early 1949. The Chiang government fell and moved to Taiwan".

democratic system. Keynes foresaw this detrimental effect of a deflation also very clearly. When he visited Germany in 1932 shortly before the National Socialists came to power. **Keynes** (1932, p.366) observed

> Germany today is in the grip of the most terrible deflation that any nation had experienced.... Nearly a third of the population is out of work. The standards of life of those still employed have been cruelly curtailed. There is scarcely a manufacturer or a merchant in the country who is not suffering pecuniary losses which must soon bring his business to a standstill. ... Parents see no careers or openings for their offspring. The growing generation is without the normal incentives of bourgeois security and comfort. Too many people in Germany have nothing to look forward to – nothing except a 'change' – something wholly vague and wholly undefined, but a change.

Keynes' description of a catastrophic deflation in Germany might well supply still today a warning to avoid a repetition of such a state of affairs. Historical experience shows that if the economic situation becomes too desperate, the desire for *economic* 'change' might lead to catastrophic *political* consequences. As far as the German deflation in 1932 was concerned, it was followed by an electoral victory of the Nazi party in 1933.[2] Eventually this course of events led to the unleashing of World War II in Europe and to its well-known consequences for Europe and for the rest of the world.

In the wake of the financial crisis of 2008 there were serious and urgent warnings that this time, too, a severe *economic crisis* could turn into a far greater *political crisis*. Thus, Noeleen **Heyzer** (2009, p.vii), Under-Secretary-General of the United Nations, warned of

> a significant risk that developed country recession may evolve into a deeper and wider regional crisis that will bring with it political instability, widespread social unrest, further downward pressures on economic growth, rising unemployment, and a new cycle of crises, both within and among countries.

As we saw above, Keynes focussed the evils of both, inflation *and* deflation. But his lasting importance for economic policy stems not from such cogent *de*scriptions. It stems rather from his new analytical groundwork for economic *pre*scriptions. It was he who successfully undertook the task of re-shaping established economic theory which at that time was unable to propose efficient economic political tools which were appropriate for the type of economic problems posed by the Great Depression (**Keynes**, 1936). His – at that time newly propagated – doctrine of "effective demand" eventually entered the macroeconomic textbooks and created an entirely new brand of economic policy advice.

For decades after World War II full employment was the economic political preoccupation of many capitalist economies. Governments freely took responsibility for full employment policies. Keynesian "demand-side economics" was the economic theoretic and economic political lesson of the experience of the Great Depression. For many years it seemed that this new paradigm was able to give the necessary instruments for continuing economic growth and stability based on "mild", that is indirect, government intervention through macroeconomic demand management. Maybe one of the best formulations of the old "Keynesian Consensus" was formulated by Paul A. **Samuelson** (1966, pp.1482-3),

[2] But see **Decressin** and **Laxton** (2009) for a brief historical review which also gives examples of less detrimental episodes of deflation.

the later Nobel laureate. As economic theorist he is praised for his rigorous formulation of "neo-classical" price theory. But when he gave economic political advice to the newly elected US-American President John F. Kennedy in 1961 he formulated the following "Keynesian" credo:

> History reminds us that even in the worst days of the Great Depression there was never a shortage of experts to warn against all curative public actions, on the ground that they were likely to create a problem of inflation. Had this counsel prevailed here, as it did in pre-Hitler Germany, the very existence of our form of government could be at stake. No modern government will make that mistake again.

Thus the legitimacy and necessity of "Keynesian" government action in cases of economic recession seemed to be out of question – in spite of the constant fear of inflation.

But the downfall of the Bretton Woods System in the 1970ies led to a dramatic shift of economic political perspective. It led to a new, a third, set of economic problems which went under the name of "stagflation". This name stood for a seemingly contradictory combination of *stag*nation of economic activity and for high unemployment on the one hand and for in*flation* on the other hand. This contradicted the customary pattern of economic political opposites mentioned above. Henceforth it was not unemployment which was the main economic political concern but inflation. The monetarist school of explaining the causes of inflation ruled for the subsequent decades. The capitalistic world was now convinced that the core economic problems were to be solved not by Keynesian "effective demand" policies but by all sorts of supply considerations:

- the supply of money determining the rate of inflation
- the supply of labour determining employment
- the supply of capital – as material, as human and as social capital including "entrepreneurial attitudes"– determining income and its growth

For decades macroeconomic demand considerations of the once wide-spread Keynesian type seemed to be totally outmoded in academic economic discourse and in economic political discourse as well.

But the supply side oriented economic political doctrines of the past decades left the world unprepared for the economic crisis of 2008/9. Some economists claim that a crisis will always hit the world unprepared, otherwise it would not be a crisis. Thus, they claim, the appearance of the crisis cannot be seen as a failure of economics. But such an excuse for the lack of economic foresight is not helpful for mastering the *consequences* of the crisis. There is the obviously pressing question: what can economic policy do *now*?

The prospect for the aftermath of the crisis of 2008/9 was for many economists that there could be a repetition of the scenario of the Great Depression after 1929. As then the appropriate answer appeared in the form of Keynesianism, so now the economic profession remembered again the once revolutionary doctrines of J.M. Keynes.

Thus the current global economic crisis changed radically the prevalent global economic political discourse. It shifted from the previous supply side preoccupations to a re-discovered demand oriented Keynesianism. This Keynesian orientation is currently particularly noticeable in China. But in Europe it seems that "economic political correctness" in many European countries still requires to pay lip service to the economic credos of the former monetarist era. It is this difference which will be documented and discussed in the following.

2. Definitions and Data

2.1. **The problematic definitions of unemployment.** The concept of "unemployment" seems to be quite straight forward: according to the OECD terminology: "Unemployment rates represent unemployed persons as a percentage of the labour force (the total number of people employed plus unemployed)". In standard economic terms, "unemployment" pure and simple should mean an excess supply of labour on the market for labour services. The "pure and simple" case refers to conditions in which market frictions are not accounted for. Otherwise one might discern "involuntary unemployment in the strict sense" and "frictional unemployment", the latter being due to inefficiencies on the labour market. An additional category is "voluntary unemployment" which is due to unwillingness to work – either out of laziness or out of sufficient non-work income or other reasons due to which potential workers might have a high "reservation wage", i.e. a wage level which, when not reached by the wage offered on the labour market, could not entice people to go to work. One of the often heard reasons for this type of unemployment is a rather high level of social security which enables people to survive fairly comfortably without going to work.

When it comes to economic policy against unemployment, the important questions are: who should take responsibility for unemployment – and: should the administration take any responsibility at all in the context of unemployment? It might be convenient for politicians to find advisors who suggest to them and to the general public that there is no such thing as a "problem" of unemployment – apart from laziness and ignorance of workers and of featherbedding the voters by too soft politicians. As an Australian economist (**Quiggin**, 1993) once quipped:

> One method of guaranteeing that existing policies will restore full employment is to redefine full employment as the employment level generated by existing policies. This strategy of 'moving the goalposts' has been employed using the concepts of the 'natural rate of unemployment', "one of the most vicious euphemisms ever coined" as William Vickrey president of the American Economic Association [and then Economics Nobel Laureate of 1996, GMA], wrote recently.

Sometimes there are maybe also administrative reasons for definitions which are not in agreement with the above quote from the OECD. Thus **OECD** (2009a) pointed out

> It should be noted that Chinese unemployment data are based on the number of people registered as unemployed with the Ministry of Labour and as a result are not comparable with data compiled by other countries which by and large are derived from household labour force surveys. Persons without formal authorisation to live and work outside rural areas and who have moved to the cities to look for work cannot register at labour exchanges and are therefore excluded from the unemployment figures. Similarly, all workers laid off from state enterprises that since 1998 have been entitled to social welfare benefits also cannot register as unemployed.

This statistical difference could result in a miscalculation of the potential problems which unemployment might entail. As **Giles** *et al.* (2005) conclude: "the unemployment rate could underestimate the actual dislocation experienced by workers in urban China".[3] Their calculations of realistic rates of unemployment end with the year 2002 and thus they are not of great relevance for the present situation, however. A more recent indication of the discrepancy between the statistical and the factual magnitude of the problem was given by **Pettis** (2009):

> Although official estimates put urban unemployment in China at just over 4 percent of the workforce, most unofficial estimates are much higher – closer to 8 percent – and nearly everyone agrees that the figure is set to rise significantly in the next few months. Some credible estimates suggest that even if China were able to achieve the 7.5 percent growth projected in 2009 by the World Bank, unemployment would nonetheless double before the end of the year.

It seems that indeed the problem of unemployment has increased dramatically also in China where, due to the particular way of defining rates of unemployment, the official rate is predicted to be not very much above the seemingly customary rate of 4,0% which prevailed over the last years. An indication of increasing public awareness in China that there might be a build-up of considerable social problems in the context of that part of unemployment which does not appear in the official statistics is given by a news item in **People's Daily Online** (2009a). On February 02 2009 the paper reported that "Chen Xiwen, director of the office of the central leading group on rural work, said about 15.3 percent of the 130 million migrant workers had returned jobless from cities to the countryside."

The social evils of unemployment and unequal coverage of care for needy workers were addressed indirectly by the Chinese Premier **Wen** (2009b) Jiabao when he delivered the "Report on the Work of the Government" for 2009. On that occasion he explicitly referred to "the unemployment" and to " workers' compensation and maternity insurance steadily expanding to cover more workers". Subsequently there was much reporting in the newspapers on the respective problems which were addressed by such remarks. Thus, **Beijingreview.com.cn** (2009) commented:

> First of all, social security coverage must be broadened. . . . When coping with the 1997 Asian financial storm, China had in the meantime built up a security system covering urban areas. Considering that migrant workers bear the brunt of unemployment, the government should extend its current urban social security network to rural areas, which would help lay a framework for a future social security system and coordinate urban and rural development.

But until now the "statistical problem" that unemployed rural workers are not counted as "ordinary unemployed" in China is obviously also a social problem.

2.2. **The global economic crisis.** The economic problems of the year 2009 are often referred to as coming from the "global financial crisis" which was triggered by the collapse of the US-American market in "subprime" credits in 2007. Some supposedly knowledgeable commentators believed in 2008 already that after some massive bank bail-outs "we may have seen the worst" (Economics Nobel Laureate Robert Engle in **Engle** *et al.* (2008)

[3]See also **Giles** *et al.* (2005, table 3) for a concise comparison of international definitions of rates of unemployment

Table 1. Selected *World Economic Outlook* Projections (based on IMF 2009 a,b,c)

	realizations		projections Jan. 2009		projections April 2009		difference between projections	
	2007	2008	2009	2010	2009	2010		
Column number	(1)	(2)	(3)	(4)	(5)	(6)	(5)-(3)	(6)-(4)
World output[a]	5.1	3.1	0.5	3.0	-1.3	1.9	-1.8	-1.1
United States	2.0	1.1	-1.6	1.6	-2.8	0.0	-1.2	-1.6
China	13.0	9.0	6.7	8.0	6.5	7.5	-0.2	-0.5
Euro area	2.7	0.8	-2.0	0.2	-4.2	-0.4	-2.2	-0.6
Germany	2.5	1.3	-2.5	0.1	-5.6	-1.0	-3.1	-1.1
European Union	3.1	1.1	-1.8	0.5	-4.0	-0.3	-2.2	-0.8
World growth[b]	3.8	2.0	-0.6	2.1	-2.5	1.0	-1.9	-1.1
World trade volume[c]	7.2	2.9	-2.8	3.2	-11.0	0.6	-8.2	-2.6
Imports								
Advanced economies	4.7	0.4	-3.1	1.9	-12.1	0.4	-9.0	-1.5
Emerging and developing "	13.8	9.4	-2.2	5.8	-8.8	0.6	-6.6	-5.2
Exports								
Advanced economies	6.2	2.0	-3.7	2.1	-13.5	0.5	-9.8	-1.6
Emerging and developing "	9.5	4.1	-0.8	5.4	-6.4	1.2	-5.6	-4.2
Commodity prices (U.S. dollars)								
Oil	10.7	36.4	-48.5	20.0	-46.4	20.2	2.1	0.2
Nonfuel[d]	14.1	7.5	-29.1	7.3	-27.9	4.4	1.2	-2.9
Consumer prices								
Advanced economies	2.2	3.4	0.3	0.8	-0.2	0.3	-0.5	-0.5
Emerging and developing "	6.4	9.3	5.8	5.0	5.7	4.7	-0.1	-0.3
London interbank offered rate (percent)								
On U.S. dollar deposits	5.3	3.0	1.3	2.9	1.5	1.4	0.2	-1.5
On euro deposits	4.3	4.6	2.2	2.7	1.6	2.0	-0.6	-0.7
On Japanese yen deposits	0.9	1.0	1.0	0.4	1.0	0.1	0.0	0.1

[a]For statistical conventions and definitions for this table see **IMF** (2009a)
[b] "based on market exchange rates"
[c]"goods and services"
[d]"average based on world commodity export weights"

). But more pessimistic commentators were nearer to the truth. The financial crisis soon developed into an all-out global economic crisis, the dimension of which still being not clear while the year 2009 comes to a close. In the meanwhile, economic research institutes and international economic agencies repeatedly had to revise downward their macroeconomic predictions . Some of the latest figures from the *World Economic Outlook* of the IMF of January 2009 and of April 2009 are given in table 1.[4]

The most interesting aspect of these figures is not so much their absolute numbers but their sign values: the growth of GDP in most countries (with the noticeable exception of China) is negative in 2009 – in most developed economies a phenomenon not experienced

[4]The "realizations" figures of the first two columns are the latest available as given by **IMF** (2009c).

since decades. World trade – imports and exports all over the world – is shrinking dramatically. Commodity prices are in steep decline and consumer prices are stagnant, thus warranting the concern about "deflation" as mentioned in the introduction above.

At the bottom of the table we can see that key interest rates – whether measures in Euros, in US-dollars or in Japanese yen, all are at historically low levels, thus demonstrating the monetary authorities' attempt to stimulate their economic activity by injecting liquidity massively into the respective economies, but to no avail. Every new *Outlook* shows bleaker projections for the future. The last two columns of table 1 demonstrate that about all the pessimistic projections which were published in January 2009 turned out to be too optimistic by April 2009 and the same holds true for most of these data in July 2009 (**IMF** 2009c, new projections not reproduced in table 1.)

According to the early projections world growth (based on market exchange rates) should have reached a slightly higher level (2.1%) by the year 2010 than the level of 2008 (2.0%). But the markets were deficient in self-healing capacities. With ever decreasing projections for the year 2009 it slowly dawned upon many economic commentators that the depth of the crisis became increasingly deeper in spite of all the injections of liquidity just mentioned. According to the formerly prevailing monetarist tradition it was bound that such inflation of liquidity was tantamount to raising inflationary price-expectations: But as the figures show, the expectations for consumer prices had to be revised downwards and not upwards – and in any case they were very low and even negative in some cases.

By the year 2009 the world was in a decidedly anti-monetarist setup in which inflationary expectations were independent of government deficits and independent of money supply and where the low level of economic activity was seen predominantly in connection with the blatantly deficient "effective demand". It was an economic world where Keynesian ideas seemed to be the most appropriate analytical framework for dealing with the prevalent mix of economic problems. As **Prasad** and **Sorkin** (2009) of the Washington Brookings Institution remarked: "Fiscal stimulus [as suggested by J.M. Keynes, GMA] has a crucial role to play in stabilizing the world economy, especially as conventional monetary policy appears to have reached its limit in many countries." – with the latter remark alluding to the Keynesian "Liquidity trap" of extraordinarily low interest rates which were noted above already.

Even staff members of the World Bank, an institution which a few years ago was not at all known for having inclinations towards Keynesian macroeconomics[5], came to call for a "Global Fiscal Stimulus" and declared, after detailed investigation (**Freedman** *et al.*, 2009, p.5):

> On balance, the evidence provides some support for the view that, in the current environment where monetary policy remains accommodative, a well-executed global fiscal stimulus could provide an appreciable boost to the world economy in crisis.

Words like these coming from the "lion's den" of the former "Washington Consensus" heralded now a new economic political era in which "fiscal stimulus" had become the most important economic political catchword.

[5]For a scathing criticism of the "IMF–World Bank ideologically driven Washington Consensus policies" (**Stiglitz**, 2006, p.277) see **Stiglitz** (2006, ch.2) who based his criticism on his insider experience as erstwhile Chief Economist of the World Bank from 1997 till 2000.

3. Some Chinese policy responses

3.1. **The Keynesian tradition.** Although the Keynesian policy prescriptions were originally proposed in response to a systemic problem of the mature *capitalist* economies, namely the Great Depression of the 1930ies, the reformed communist China by now has a tradition to be quite prone to apply Keynesian ideas in the case of crisis. The **World Bank** (2008, p.12) has an interesting reference to China's reaction to the 1997 Asian Crisis. Although she was not very much directly affected at that time since China was able to maintain a stable exchange rate, China did suffer a considerable slowdown of economic growth rates in the wake of the Asian crisis. Although that slowdown was seen at that time as an expression of structural weaknesses in China's economy, her economic political response was not focussed just on structural reforms in the narrower sense. According to the figures given by the **World Bank** (2008, p.12), the budget deficit rose during the aftermath of the Asian Crisis from 0.7% to 2.6% of GDP in 2002. Although exact figures are missing about the type of additional expenditures, the authors estimate that in 2000 infrastructure investment in China was 10% of GDP. Subsequently, when growth rates picked up again, the public deficit was reduced, giving a budget surplus in 2007 when China experienced up to 12.6% annual growth rates. Tight fiscal policy in a boom is, of course, the right corollary to Keynesian deficit spending in a slump. This is "anti-cyclical" economic policy at its best – to spend when effective demand is deficient and to curb spending when the economy is booming. The **World Bank** (2008, p.11) acknowledged that the Chinese authorities followed a "prudent" approach to fiscal and monetary policy in the past, and they endorsed expansionary fiscal policies under the conditions of the crisis of 2008/9.

3.2. **The current Keynesian demand response in China.** When Chinese Premier **Wen** (2009b) Jiabao delivered his government report on March 5, 2009, he clearly spoke in definitely Keynesian terms and thus he was quite in keeping with the tradition just mentioned. Commenting on the contemporary global crisis he mentioned global lack of demand, fear of deflation, the challenge of overcapacity in production and the problem of stimulating domestic consumer demand:

> First, the global financial crisis continues to spread and get worse. Demand continues to shrink on international markets; the trend toward global deflation is obvious; and trade protectionism is resurging. The external economic environment has become more serious, and uncertainties have increased significantly.
> Second, continuous drop in economic growth rate due to the impact of the global financial crisis has become a major problem affecting the overall situation. This has resulted in excess production capacity in some industries, caused some enterprises to experience operating difficulties and exerted severe pressure on employment. Factors leading to decline in government revenues and increase in government expenditures have increased. It has become more difficult to maintain steady agricultural development and keep rural incomes growing.
> Third, institutional and structural problems that have long hindered healthy economic development still remain, and some of them are still prominent. Consumption demand is insufficient . . .

Table 2. Stimulus

	Initial Conditions		Spending in 2009			Total stimulus size		
	Gross Public Debt*	Fiscal Balance 2008*	in USD	rela-tive*	Tax cut share	in USD	rela-tive*	Tax cut share
China	15.7%	0.4%	90.1	2.1%	0.0%	204.3	4.8%	0.0%
France	64.4%	-2.9%	20.5	0.7%	6.5%	20.5	0.7%	6.5%
Germany	62.6%	0.9%	55.8	1.5%	68.0%	130.4	3.4%	68.0%
UK	47.2%	-4.8%	37.9	1.4%	73.0%	40.8	1.5%	73.0%
US	60.8%	-3.2%	268.0	1.9%	44.0%	841.2	5.9%	34.8%

* as percent of respective 2008 GDP

Sources: IMF, CIA World Factbook, various news sources and calculations by **Prasad** and **Sorkin** (2009).

Actually, the policies which corresponded to this diagnosis had been decided several months before when the Chinese government announced a "Stimulus Package" worth four trillion yuan ($586 billion) over the coming two years. At that time this volume, which, after some estimates, would have been 16% of GDP, was met abroad with scepticism. Thus the **Economist** (2008) quoted an expert stating that "the size of this stimulus package – which is expected to be in the form of additional spending – may have been overstated". A more recent international comparison of in some way comparable stimulus packages by **Prasad** and **Sorkin** (2009, p.5) – reproduced in part in table 2 – assessed the Chinese stimulus package at only 4.8% of the 2008 Chinese GDP (second last column in table 2). Even at this lower percentage value, China clearly is one of the strongest "stimulus package" actors, comparable in size mainly with the USA which, according to table 2, has a "stimulus package" amounting to 5.9% of its 2008 GDP. The only other major economy with a comparable relative volume is Germany with 3.4% – a figure which will be discussed further when we focus on the European reaction.

3.3. **Assessing the Chinese response .** There are several reasons why it is rather difficult to make a fair assessment of the appropriateness of reactions to the crisis of 2008/9. There is wide consensus that "Keynesian stimulus" policies are the order of the day. But what exactly is such a policy? Table 2 shows that some countries react to the crisis by reducing taxes massively, while others – in particular China – do not appear to employ tax reductions at all as part of the stimulus package (last column of table 2).

Also, there is the problem of the scope for increased government spending. Focus the initial conditions before the crisis as described in the first two columns of table 2: it should be clear that a country like France with a large stock of government debt and with a prospective budget deficit of almost 3% of its GDP even before the outbreak of the crisis has considerably more problems to finance a stimulus package and to further expand government debt than China. She had one of the lowest outstanding government debt ratios and was predicted to have a budget *surplus* before the crisis. This is, of course, an ideal starting point for a "stimulus package" in order to respond to a negative demand shock by embarking on debt financed additional expenditure.

A further point of discussion is: given a certain volume of additional government expenditures – to which sectors of the economy should such expenditures go in order best to stabilize the economy? In the *General Theory* **Keynes** (1936, ch.20) devoted an entire chapter to a discussion of the formal characteristics of "employment functions". These functions are meant to identify how strongly employment reacts in different industries when there is a given increase in effective demand. This type of analysis has never been followed up in serious empirical work (for an *analytical* elaboration of Keynes' concept of employment functions see this author's monograph **Ambrosi** 1981). But of course, it is a matter of common sense that when the task is to stabilize employment that then special attention should be given to those sectors of the economy which are in the best position for this aim. In implementing its "stimulus programme", China seems to have been quite successful in addressing the "right" sectors in this sense, as was recently argued by Vivek Arora, IMF Senior Resident Representative for China based in Beijing, in a press conference.(**IMF**, 2009e)

> I think there are two forces going on [in the pursuit of the Chinese stimulus package].
> (1) ... a reallocation of production from the coastal areas, such as the Pearl River Delta which primarily serves the export market, towards some of the more inland production centers, like the Yangtze River Delta which is heavily involved in the production of consumer durables. And the strength in retail sales which has been focused on consumer durables has absorbed some of the labor that was laid off from the export industries.
> (2) ... the fiscal stimulus has fallen very heavily on infrastructure spending, and that seems to have absorbed some of the labor in the inland areas.
> I think there are still some outstanding concerns like college graduates and so on, but I think that on the whole the labor market situation is a lot better than one would have expected about a quarter ago.

In other words: considerable parts of the "stimulus package" money in China went (1) towards sectoral and regional re-structuring and (2) towards infrastructure development. Both set of measures were considered as being sound economic policies by the staff of the IMF as we just saw. They achieved the main aim of stabilizing employment, as was stressed in the quote just given. In addition, the measures under (1) helped China to somewhat wean itself from her old pattern of export-led growth while the measures under (2), by improving the infrastructure of the economy, improved the over-all productivity through better roads, harbours, communication lines etc.

If we look at the budget for the Chinese "stimulus package" in more detail (table 3), we notice that in the course of its implementation there has been some re-emphasis. Concerning these changes there has been some debate about the fact that this re-emphasis hit, to a considerable extent, the position "Energy conservation and environment" which was cut by 140 bio yuan. Since environmental protection was one of the sacrifices which were made anyhow for the sake of a quick implementation of economic stimulus, this change did little to redress a truly problematic aspect of implementing the "stimulus package".

The problems concerning environmental protection which went with the "stimulus package" were illustrated by **Zhang** and **Xi** (2009) with the following figures: during the implementation of the package from December 2008 until May 2009 – a time span for which they could find informative statistics –, construction projects which were approved by the Ministry of Environmental Protection (MEP) were outnumbered by projects which did not have such clearance by 339 to 590 times. An effective control of environmental protection can hardly be expected in view of such a discrepancy between environmentally approved and not approved construction projects. But according to these authors there were subsequently serious attempts by the central government to regain more control in the field of environmental protection.

Table 3. The changes in the Chinese "stimulus package" (source: **Batson** 2009)

Components of plan in billions of yuan	Nov. 2008	Mar. 2009	Change
Health care and education	40	150	110
Technical upgrading and R&D	160	370	210
Public housing	280	400	120
Energy conservation and environment	350	210	-140
Rural infrastructure	370	370	0
Post-earthquake reconstruction	1000	1000	0
Transport and power infrastructure	1800	1500	-300
Total	4000	4000	

A further noticeable change which occurred during the implementation of the "stimulus package" was a sizeable shift towards the first two positions, namely "Health care and education" and "Technical upgrading and R&D". We will see below that especially the former position was indeed justified to be treated more favourably than originally planned. The resources for these changes came largely from reduced spending on "Transport and power infrastructure" but when we look at the relative size of infrastructure expenditures as identified by the last three rows, we will see that almost 3000 bio. yuan out of 4000 bio. are still earmarked for infrastructure – an allocation which found favourable comment in international circles as we just noted above.

One might compare the Chinese performance with the German one, especially in the context of the above mentioned "item (1)" – replacing export oriented production by domestically oriented production. Germany has about the same volume of exports as China and correspondingly she is particularly heavily affected by the collapse of world trade, a fact which which we noted above in connection with the discussion of table 1. But Germany was unable to engage in a comparable re-structuring of her economy in a short time. The German economy is still far from restructuring so that her industry becomes less export-oriented. The German economy has not become more oriented towards domestic demand as consequence of the recent crisis. So, this seemingly obviously desirable re-structuring is one of the specific successes of the Chinese version of implementing a "stimulus package" if we may follow the quoted assessment by the IMF representatives.

Briefly commenting also on the "item 2"-issues of infrastructure investment, we may note that probably there is not a comparable necessity for regional development in Germany as it is in China. But it is interesting that there is currently much public debate in Germany that there the provincial governments failed to absorb the resources which were made available through the German federal version of a stimulus package. One reason for sluggish application for the use of the earmarked funds in Germany, both on the federal and on the regional level – and this reason might also be relevant for evaluating the impact of the stimulus package in other Western countries – is that there just were not sufficient public plans ready for being enacted for improving the public infrastructure. Over decades there were ideological predilections to privatize as much as possible of public infrastructure – from water supplies to electricity supplies and transport systems and other "public" utilities like postal services. In Germany and other countries of the West, infrastructure development and management just was not focussed sufficiently by the public administration any more and therefore it seems that public administrations were unable to respond quickly when increased infrastructure investment was desirable for employment political reasons.

But it seems that this latter point is not uncontroversial. Thus, the London **Economist** (2009, p.22), in an assessment of China's application of her stimulus package, commented

> In general terms, the interventionist state is once again taking the leading role in directing the Chinese economy. This phenomenon has been popularly described as a reversal of the political slogan "state retreats, the private sector advances" . . . to signify the dominance of the state sector in the economy.

But in the European history of privatization since the days of the British Prime Minister Margaret Thatcher and many other neo-liberalist politicians there have been quite a number of serious cases where the retreat of "the state" has been bemoaned by the general public and not been praised. The wide-spread discontentment in the Economist's homeland Great Britain about the appalling level of service and security offered by the privatized – once publicly owned – railroads is an interesting case of failed privatization. Surely many members of the British public would not regret if the British state advanced once again into the management of British railroads.

An English proverb says that "the proof of the pudding is in the eating" – and, we may add, the proof of the quality of a pudding does not lie in the ideology of the waiter serving the pudding. In the context of assessing the Chinese enactment of her "stimulus package" the proof of its merits is in the performance of stabilizing the economy and the level of employment. Now, as far as employment is concerned we just quoted the favourable comments from **IMF** (2009e).

As far as the other aim is concerned, namely stabilizing the economy, we may draw attention to the *World Economic Outlook Update* of July 2009 (**IMF**, 2009c) and to the fact which we mentioned in discussing table 1 above. We observed that for most countries projection after projection had to be revised downward because of the unfortunate unfolding of the crisis. The latest *Outlook* (**IMF**, 2009c) again confirmed this pattern of dwindling expectations for most countries. But there were now some very few exceptions with the USA and China being among those where expectations had to be revised upwards. For the former the new projection of GDP growth was up by 0.3%, for China the newest growth projection was up by 1.0%. Both these countries were among the most active with regard to "stimulus packages". This observation is, of course, not a strict *proof* of the success of the measures taken in China but they are a good indication that – especially in China – the demand oriented stabilization efforts did have their desired effects if they were indeed carried out in a decisive way.

The probably successful turn-around of the economic slowdown in China should settle the doubts about the size of the Chinese "stimulus package" in the sense that it obviously seems to have been sufficient. But there is more to the Chinese stabilization efforts than just this package. We did not enter a discussion of its "true" size in the above because its exact magnitude is really a question of secondary importance if we consider the following comment on the Chinese response to the 2008/9 crisis which recently appeared in *The Wall Street Journal* (**Shih**, 2009)

> ...the current central stimulus package of four trillion yuan ($586 billion) is a side show compared to the 20-plus trillion yuan in investment planned by local governments. For some reason, Beijing has shown little willingness to constrain fantastical local investment plans. The National Development and Reform Commission (NDRC), previously a bastion against uncontrolled local investment, has shown nothing but great enthusiasm for approving local construction projects. The NDRC even has devised ways to allow local governments to borrow more by using long-term loans from policy banks or bond issuance as the 30% required initial capital. Local governments then can borrow the rest from commercial banks, effectively financing some projects entirely with debt.

Thus the volume of effective demand unleashed alongside with the "stimulus package" is a manifold of the package itself so that bickering about relative stimulus commitments of the G-20 countries is really trivial in the case of China.

But there seems to be some concern in China by now that some of these enthusiastically pursued projects might turn out to be "wasteful" and not very productive. In the face of such concerns let us remember the original advice which Keynes gave in the *General Theory* (**Keynes**, 1936, ch.10)

> For a man who has been long unemployed some measure of labour, instead of involving disutility, may have a positive utility. If this is accepted, the above reasoning shows how 'wasteful' loan expenditure may nevertheless enrich the community on balance. Pyramid-building, earthquakes, even wars may serve to increase wealth, if the education of our statesmen on the principles of the classical economics stands in the way of anything better.

In spite of this reassuring advice from the founding father of Keynesianism, the **Economist** (2009, p.28), in the assessment of China's stimulus package mentioned above already, voiced severe "concerns" about the over-abundance of "white elephants" generated by the "stimulus package" – about projects with high consequential costs and low economic returns. The Economist does give a number of examples substantiating the claim that there were hurriedly decided and costly projects. But trained economists should be accustomed to the idea that it is not just "costs" which should be our concern but rather "*opportunity* costs". The alternative faced by the Chinese administration for 2009 was not to take all the time needed for optimal decisions on the one hand or, on the other hand, to have hurried bad decisions instead. The alternative was: either to do nothing for the moment and to let the downward spiral go its course or else to generate as much stabilizing effective demand as possible during the just evolving crisis. If seen in this light – and in view of Keynes' above quoted advice that it is better to have "wasteful" demand which cures unemployment than to have no demand at all – the Economist's just mentioned assessment seems to be not quite appropriate for the present.

But there *can* be doubts about the sustainability of the present Chinese pace of demand stimulus. As the already quoted comment in the Wall Street Journal (**Shih**, 2009) observed: "the greater the extent to which lending [in China] is uncontrolled at the moment, the bigger a nonperforming loan problem the central government will face in the future." This is indeed a rather intriguing vision: in fighting the danger of the global financial crisis of 2008 becoming a national crisis for growth end employment in 2009, the Chinese authorities' Keynesian response to this crisis is sowing the seeds for a new financial crisis of non-performing loans – maybe as early as 2010.

There is indeed a potential problem associated with Keynesian demand policy in general: who is going to pay for the massive "stimulus packages" which seem to be called for at the moment of crisis? Especially in the European public there is much apprehension that the fiscal stimulus packages might shift the burden of adjustment from the present generation to the future ones who will have to service and to pay back the increased public debt. Before this background it is interesting that the **People's Daily Online** (2009c) published an expert opinion (Jing Linbo, assistant director of a Peking based government think tank, the "Institute of Finance and Trade Economics") claiming that China's public revenue will be boosted by their fiscal stimulus measures. This is, of course, in line with the Keynesian doctrine of "pump priming". It is also in line with the World Bank's (2008) account of the Chinese reaction to the 1997 Asian Crisis which was referred to at the beginning of this section. We will return to this topic in section 4.6 below (see there in particular the discussion of equ.(7)).

3.4. **China and the "Savings Glut" hypothesis.** The 2008 economics nobel price laureate Paul **Krugman** (2009) recently remarked:

> How did this global debt crisis happen? Why is it so widespread? The answer, I'd suggest, can be found in a speech Ben Bernanke, the Federal Reserve chairman, gave four years ago.

He thereby endorsed Bernanke's doctrine of the "savings glut" explanation of global trade imbalance (**Bernanke**, 2005). Krugman put it in the center of attention in the search for explanations of the present global economic crisis.

The basic idea behind this argument is simple. It is not a falsifiable hypothesis but an accounting identity. If GDP is defined as accruing from the production for consumption (C, government and private), for gross investment (I) and for the current account (CA), then we have

$$\text{GDP} \equiv C + I + CA \quad ; \quad \text{resp.} \quad I + CA \equiv S \tag{1}$$

where (gross) savings (S which here covers also depreciation) is defined as the difference between GDP and consumption. Now suppose there are two countries "US" and "CN". While US has a current account deficit ($-CA$) – it uses nationally more goods and services than it produces, CN has a current account surplus ($+CA$) – it produces more than it uses domestically. If we disregard investment I, it follows now immediately from equ.(1) that in order to maintain the equality we must have

$$-CA^{\text{US}} \to -S^{\text{US}} \quad ; \quad +CA^{\text{CN}} \to +S^{\text{CN}} \tag{2}$$

which means: country "US" with a current account deficit must "dis-save", i.e. it runs down its assets and / or it must ask new credit from abroad in order to finance the excessive imports while country "CN" with a current account surplus does not use up its entire production and thus by definition it has positive savings. These savings are newly acquired assets which consist in new credits which CN gives to those who cannot pay in kind for their imports. If now the rest of the world has just about balancing current accounts, we necessarily must have $-S^{\mathrm{US}} = +S^{\mathrm{CN}}$, i.e. the excessive spending of US must be financed by some other country, by CN in this case.

This little exercise in accounting is a gross simplification of the factual world economy, of course.[6] But our equations do catch a remarkable phenomenon of the pre-crisis years. The British historian Niall **Ferguson** (2008, p.335) characterised it with the following parable of "Chimerica"

> Welcome to the wonderful dual country of 'Chimerica' – China plus America – ... For a time it seemed like a marriage made in heaven. The East Chimericans did the saving. The West Chimericans did the spending. Chinese imports kept down US inflation. Chinese savings kept down US interest rates. Chinese labour kept down US wage costs.

It is hard to follow from this that since China has indeed a high and rising savings rate (see fig.1) that this country "caused" a savings gap which had to be filled by the USA through consumption – more or less against their will – if nobody else filled it.

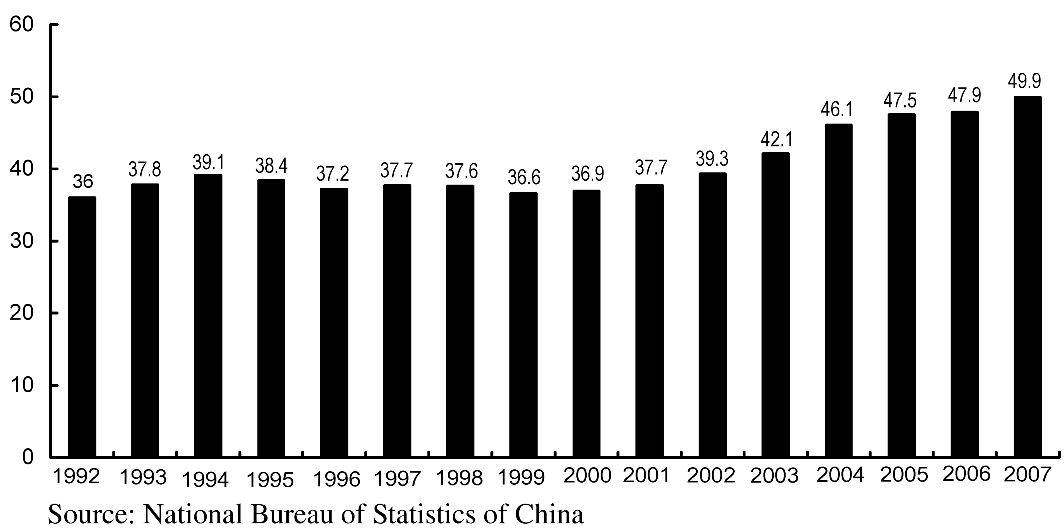

FIGURE 1. China's Savings ratio in 1992-2007 (**Zhou**, 2009a, p.11)

Against Krugman's "savings gap" explanation of the current crisis it must be pointed out that the demonstrated GDP-accounting is indeed "mere" accounting which is a manipulation of identities which *must* be right unless fraudsters are at work. But an identity says nothing about causality and **Bernanke** (2005) is eager to state that in identifying the "savings gap" he is "not making a value judgment about the behavior of either U.S. or foreign residents or their governments." Yet, just a few words before this disclaimer Bernanke does claim that "the principal causes of the U.S. current account deficit [are] outside the country's borders". Thus, although **Bernanke** (2005) certainly is clear that accounting figures only *mirror* actions and do not *cause* them, he nevertheless attributes

[6] For a more realistic juxtaposition of US and Chinese current account positions see, e.g., chart 4. in **Zhou** (2009a).

the "principal causes" for disequilibrium to those foreigners who make it possible for the USA and their citizen to run down their current account to astronomical depths, and who finance the USA's enormous budget deficits When asked about the truth of such accusations, the Chinese Premier **Wen** (2009a) Jiabao very outspokenly declared:

> I think such a view is ridiculous. I think the reason for this financial crisis is the imbalance of some economies themselves. They have for a long time had double deficits [current account deficits and government budget deficits, GMA] and they keep up a high level of consumption on the basis of mass borrowing.

One cannot but side with this assessment.

But although the "savings gap" theory of the financial crisis is to be rejected, there is indeed the problem that there is now a global deficiency of effective demand, or, as Paul **Krugman** (2009) wrote

> One way to look at the international situation right now is that we're suffering from a global paradox of thrift: around the world, desired saving exceeds the amount businesses are willing to invest. And the result is a global slump that leaves everyone worse off.

Present-day China does have a problem and a responsibility in this connection. If we look at fig.1 we will see that one of the astonishing characteristics of the Chinese economy is indeed the very high savings rate which lately reached almost 50% of GDP. The other extreme is the USA where savings rates were almost zero in the years before the global financial crisis. This is the backdrop for the "savings glut" debate to which we just referred. But no matter where one sees the causality for the present economic crisis, it is clear from

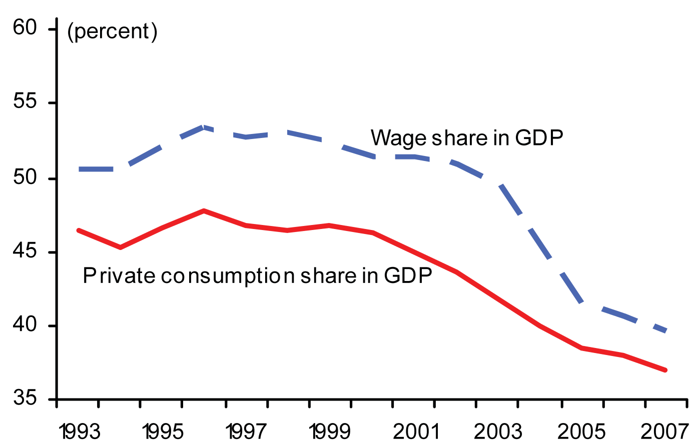

Figure 2. Share of wages and share of consumption in the PR China (World Bank (2008) p.14, fig.15)

these figures that China must have a tremendous potential for generating consumption demand. It is interesting that the Governor of the People's Bank of China **Zhou** (2009a, p.17) Xiaochuan recently addressed a Malaysian audience with the statement: "to bring down savings ratio, East Asian nations should attend to various aspects including economic growth pattern, industrial structure, pricing mechanism, etc.". Certainly China herself has an interesting agenda here.

Raising the private propensity to consume is, of course, of special concern when implementing a demand-oriented "stimulus package". We saw above when discussing table 3 that in the restructuring of the budgetary allotments of this package in March 2009 there were considerable shifts towards "Health care and education" and "Public housing". The shifts of government expenditure towards these positions could relieve the needier sections of society from many cautionary savings for provisions which they can often satisfy only with great difficulties anyhow. Thus these additional state expenditures could also set free sizeable purchasing power. It is in this sense that we must read the assessment: "The revised stimulus plan looks a bit more like what outside economists say the government should have done originally. Spending on social services now makes up 4% of the plan, instead of the 1% in the initial version." (**Batson**, 2009) It would be interesting to see in later studies whether these measures did indeed raise the private propensity to consume in China.

As the **World Bank** (2008) pointed out, the decreasing share of private consumption goes parallel with a decreasing share of wages in income. Without detailed knowledge of the data base and its international comparability it is difficult to comment on the causes for this development. But the **World Bank** (2008, p.13) report sees here an important agenda indeed

> By boosting the share of wages and household income in GDP, this would increase the role of consumption, a key goal of the government, in an economically sustainable way (Figure 15) [Here fig.2, GMA]. As such, it would also ameliorate the pressures for current account surpluses. Moreover, more labor intensive urban growth would help reducing excess labor in agriculture and the related poverty and urban-rural inequality. In addition, it would make growth less intensive in energy, raw materials, and resources, and less detrimental to the environment.

In short, by restructuring her economy in the direction of facilitating more consumption, China would live up to her tradition of Keynesianism which was quite successful in mastering the 1997 Asian Crisis. She would contribute to overcoming the present global economic crisis and she might contribute to the long-term goal of environmental friendly development if she shifted her development away from physical capital and energy intensive heavy industry towards more labour intensive and human capital intensive sectors of production. With a population so eager to study and to accumulate human capital this should be a domestically popular response to the current international imbalances. But such restructuring seems to be more of a longer-term project than a short-term reaction to the present problems.

4. European Employment Policy and the Global Economic Crisis

4.1. **The impact of the global economic crisis in Europe.** The essential points about the impact of the global crisis of 2008/9 on Europe were described above already when discussing the constantly deteriorating projections of the *World Economic Outlook* in connection with table 1. As far as Europe is concerned, a variant of that picture may be seen when turning to fig.3. It represents a subset of economic activity in Europe,

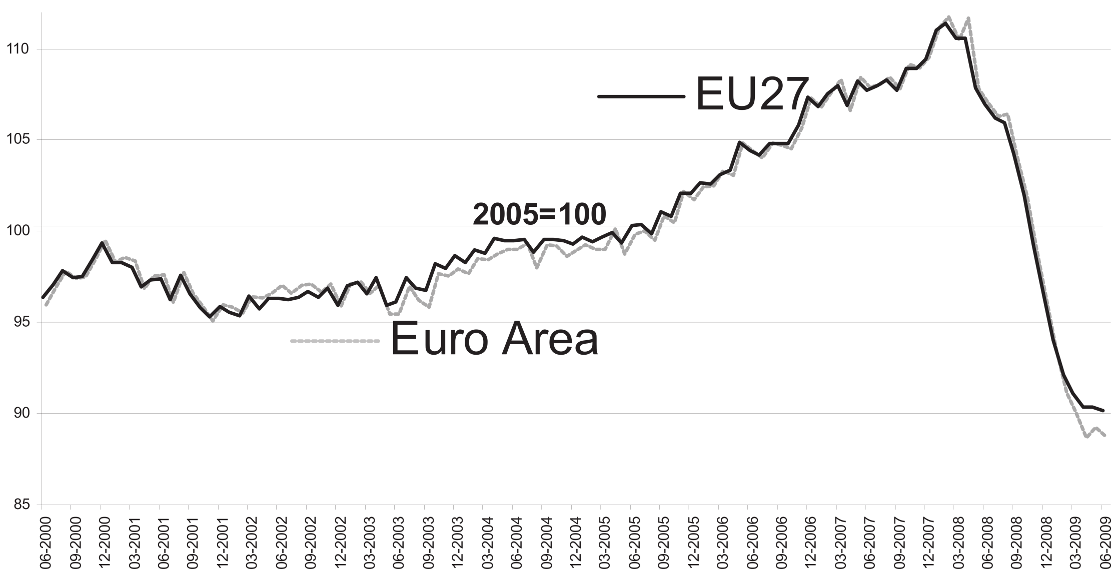

FIGURE 3. Euro Area and EU27: total industrial production excluding construction (seasonally adjusted series, source: **Eurostat** (2009, p.1)

namely industrial production. The figure demonstrates quite well the dramatic decline from a high of about 112 percentage points at the beginning of 2008 to a low of about 90 percentage points only about 15 months later.

If we looked at the underlying figures on the level of individual countries, we would find considerable variation concerning the strength of country-specific impacts but that does not modify the general fact that all the countries – whether members of the broad group of the entire European Union or whether belonging to the smaller group of members of the Euro Area[7] – they all have been hit badly. We can see from fig.3 directly that there is not much difference between the group of Euro-countries and the group of non-Euro-countries. This is in a way surprising because in view of the macroeconomic crisis being triggered by a preceding financial crisis, one could expect that the Euro Aria displays somewhat more stability. One possible explanation might be that even for countries that do not participate in monetary integration the fact of being members of the EU is a sufficiently strong stabilizing factor but this is a speculation on which we cannot enlarge in the present context.

It should be mentioned that in spite of the dire picture of the over-all economic situation, in some countries the crisis seemed to be easing somewhat in the middle of 2009. We mentioned above already that outside Europe this appeared to be the case in the USA and in China – both being countries with "stimulus packages" of considerable volumes. In Europe there are also some signs of decreasing deterioration even in Germany, a country which is heavily dependent on export demand for maintaining its level of economic activity. Since the volume of world trade is expected to decline by about 11% in 2009

[7]The Euro is now legal tender in 16 countries out of the 27 member countries of the EU. The most important non-Euro country is Great Britain where the population is strongly against abandoning the British £.

according to **IMF** (2009b) and even by 12.2% according to the latest projections (**IMF**, 2009c), hopes for an immanent end of the crisis must be met with scepticism. Signs of a slight abatement of the global crisis should therefore not detract attention from the great apprehension among the people of Europe about high future levels of unemployment and they should not weaken the resolve to pursue vigorously a novel, demand oriented, approach to unemployment problems.

4.2. **Unemployment and the crisis.** Table 1 above and figure 3 documented the dramatic decline in growth and output in selected countries due to the unfolding of the crisis of 2008/9. Since a drop in output means also a drop in inputs producing it, it is clear that the other side of the developments thus documented is also a corresponding decline of the demand for employment and eventually an increase in the respective rates of unemployment.

Table 4 shows now how the rates of unemployment changed with the successive unfolding of the crisis. Since we are dealing here with OECD-data, China is missing in these statistics but we know from the discussion in section 2 above already that there are statistical problems anyhow if we wanted to treat China in the same way as the other countries. Negative sign values show here improvements, since unemployment rates go down. We see now in the north-western block of table 4 that for the countries listed there, the unemployment situation from 2006 up to 2008 was mostly improving with the exception of the USA which in 2008 already had a considerable increase in the rate of unemployment of 1.2%.

Whereas the first three columns in table 4 show yearly changes, the rest of the columns show the increase in unemployment rates from month to month in comparison to the respective month of the previous year, namely from December 2008 to May 2009. We see that the negative signs have all disappeared during the latter months, showing a wide-spread increase in unemployment rates.

In the lower part of table 4 we show some EU-countries which were particularly badly hit: Spain, which had a decrease of unemployment in 2007 as shown by the figure of -0.2% for that years, had considerable increases ever since. In absolute terms (not shown in table 4 which is about *changes* in unemployment rates), Spain reached in May 2009 an unemployment rate of 18.7%, Ireland, which also had high rates of increases in the level of unemployment, had an absolute level of 11.7% of unemployment in May 2009. The UK which is also listed here has data only until March and they seem to be comparatively favourable with an absolute level of unemployment of 7.2% in March 2009. But in fact the UK, hosting in London a global financial center, has been among the particularly hard-hit countries due to the financial crisis.

The absolute level of unemployment was 8.9% for the EU and 9.5% for the Euro Area and thus higher as the one for the UK just mentioned. But these levels were reached in comparatively small steps, as we see from the corresponding rows in table 4. Such levels the European countries had seen in some years before and for a while they might seem to be bearable. But it is sure that these levels are not the end of the downturn and Jean-Claude Juncker, the speaker of the member countries' governments which have the Euro as their legal tender, was quoted in May 2009 already with an alarming assessment: "European countries are heading into a "social crisis" as unemployment is set to jump amid the financial and economic crisis, the chairman of the Eurogroup of finance ministers warned

Table 4. OECD Unemployment Rates: Change of rates over the same period of the previous year (source: **OECD** (2009b))

	2006	2007	2008	2008	2009				
				Dec	Jan	Feb	Mar	Apr	May
United States	-0.5	0.0	1.2	2.3	2.6	3.2	3.5	3.9	3.8
European Union	-0.7	-1.0	-0.1	0.7	1.2	1.6	1.8	1.9	
Euro area	-0.6	-0.8	0.1	0.9	1.3	1.6	1.8	2.0	2.1
Germany	-0.8	-1.5	-1.1	-0.7	-0.4	-0.2	0.1	0.3	0.3
France	0.0	-1.0	-0.5	0.7	1.0	1.3	1.4	1.5	1.7
Ireland	0.1	0.2	1.7	4.0	4.7	5.2	5.4	5.9	6.2
Spain	-0.7	-0.2	3.1	5.9	6.6	7.3	7.8	8.0	8.2
United Kingdom	0.6	-0.1	0.4	1.4	1.7	2.0	2.0		

on Monday. ...'My feeling is that many [European, GMA] politicians underestimate the extent of this phenomenon' Juncker said." (**Xinhua**, 2009)

4.3. **EU employment political institutions and actions facing the crisis.** It might seem that the EU is particularly well equipped to master an employment crisis. Its treaty base which regulates the institutions and policies of the EU resp. of the European Community, has a chapter especially addressing "Employment". This part of the treaty begins with Art. 125 TEC (**European Union**, 2002), stating: "Member States and the Community shall, in accordance with this title, work towards developing a coordinated strategy for employment ...". Article 128 then stipulates:

> 1. The European Council shall each year consider the employment situation in the Community and adopt conclusions thereon, on the basis of a joint annual report by the Council and the Commission. ...
>
> [after a complicated multi-level process of mutual consultation and examination there shall be Employment Political Guidelines and action plans for each member country until finally GMA]
>
> 5. ...the Council and the Commission shall make a joint annual report to the European Council on the employment situation in the Community and on the implementation of the guidelines for employment.

There is not much point in going into greater detail in this context and to enlarge here on the complexities of the process of employment policy formation on the level of the EU. The unfolding of the current reaction to the crisis of 20008/9 and the formulation of a "stimulus package" on the EU level supersede the statutory procedures just quoted but they correspond to them. In the following, we can illustrate sufficiently well the specificities of this policy formulation by concentrating on the latter aspect, namely the EU's reaction to the crisis.

What then *was* the EU's institutional response to the current crisis? In answering this question we must first name the three main institutional actors in this matter, namely (1) the 'European Commission', (2) the 'Councils of Ministers', and (3) the 'European Council'. Their respective roles are as follows: (1) The running *business* in the EC is done by the 'European Commission' (in Brussels).[8] (2) The running *decisions* (and many

[8]The European integration unfortunately has two treaty bases so far (a simplification of the treaty base was decided in 2008 but was not ratified by all member states by the fall of 2009). There is the "European Community" (EC) with the "Treaty of European Community" (TEC), from which I just quoted. But

decisions on the EC's laws) are done by 'Councils of Ministers', composed of member countries' ministers – in the present case of a financial crisis by the ECOFIN, the council composed of ministers for ECOnomics and FINance. The national ministers forming these 'Councils of Ministers' are members of the governments in their respective countries. (3) The heads of these national governments have a higher political status, of course, and they convene in a 'European Council'. In the European Council there is talk from one head of European national government to the others.

One might expect that the final political decisions are done on the highest level, namely by the European Councils. But the European decision making process is more complicated than that. The basic treaty (TEC) stipulates that normally no decision affecting the EC may be taken, unless it is based on a proposal of the European Commission, just mentioned above. This poses a problem because the members of the European Commission in Brussels are of lower political status than the heads of government. It is beneath their dignity to have European Commissioners make proposals what they should debate about or even what to decide. So the heads of government in the European Council cannot simply just make European decisions because their members cannot admit to follow the Commissions proposals.

Thus there are some rather intricate reasons why decision making on the EU resp. on the EC level is a rather complicated process. The unfolding of such a process in the case of deciding on the EU's "stimulus package" can be sketched as follows:

(1) The European Council (heads of governments) convenes and they voice their expectation that something will be done on the European level concerning the global economic crisis. (**Council** (2008a): "To enable speedy and effective action . . . [t]he *European Council* requests the *Council [of Ministers]* to" act.

(2) Before the just mentioned Council [of Ministers] can act and decide, the European *Commission* must prepare the public for the things to come and it has to prepare the relevant documents with proposals for action. Without the Commission's proposals no decision can be taken due to the EC-treaty provisions just mentioned. The outcome of the European Commission's preparatory phase in the case of the world financial crisis was the proposal for a **E**uropean **E**conomic **R**ecovery **P**lan (EERP)[9] in November 2008. The **Commission** (2008, p.6) explains:

> "This European Economic Recovery Plan proposes a counter-cyclical macro-economic response to the crisis . . . The Plan is anchored in the Stability and Growth Pact and the Lisbon Strategy for Growth and Jobs. It consists of:
> - An immediate budgetary impulse [by member countries] amounting to . . . 1.5% of EU GDP etc. . . .
> - And a number of priority actions, grounded in the Lisbon Strategy"

We must briefly interrupt this enumeration of the steps taken in the formulation of a European "stimulus package" in order to make a short comment concerning the "eurojargon"

there are aspects of European integration that go beyond the TEC like questions of internal security (concerned with fighting crime etc.) and of external security (concerned with military and foreign policy matters). These are regulated in the "Treaty of the European Union" (TEU) which does not concern us here. In non-technical discourse it is common to use the acronyms EU and EC synonymously, although they refer to different treaty bases.

[9]It has an own little homepage under `http://ec.europa.eu/economy_finance/thematic_articles/article13502_en.htm` with downloadable documents and web-links

used here. Two concepts must be noted in the context of step (2): "Lisbon Strategy"[10] and "Stability and Growth Pact". They are important to note because these concepts tie down the intended future actions with policy jargon – and with the associated economic political substance – which was formulated long before this crisis. Thus this jargon is not just a matter of semantics but brings in a heavy economic political load from the past. The appearance of this jargon should be taken as an indication that we have here a rather complicated terrain to cover – not only for the readers but also for the economic political actors. We will see that there is the severe danger that European employment political actors will be dramatically disoriented in this jungle of "grounding" in specific "Strategies" which seem to *have* to be pursued – no matter what sort of a crisis is going on.

(3) The ECOFIN *Council [of Ministers]* approves the EERP and proposes it to the *European Council*. The proposal states in particular that "the Council [of Ministers] supports a stimulus amounting to 1,5% of EU GDP." (**Council**, 2008b)

(4) Now the EERP , proposed by the Commission in step (2), and decided upon in step (3) is taken note of approvingly by the European Council, namely in December 2008 (**Council**, 2008c). The EERP can now be implemented on the national levels of the member countries and now the EERP can enter the Employment Political Guidelines mentioned in connection with the quote from Art. 128 TEC above.

(5) Although taken on a European level, it is the national *member governments* who have to implement the decisions of step (4). This is so because fiscal policies (budget deficits and taxes) are exclusively member country matters. But the national implementations of the EERP are inspected by the European Commission and after her proposal they are approved by the ECOFIN Council [of Ministers] (**Council**, 2009a). The ECOFIN council then asks the European Council to approve the implementations.

(6) Subsequent to the ECOFIN Council meeting of 2 March 2009 mentioned in step (5), the *European* Council of heads of government did approve the new national budgets and national employment plans (**Council** 2009b, p.5 : "The European Council endorses the updated country-specific integrated recommendations for the economic and employment policies of the Member States".)

This enormously complicated background of European economic policy formation has recently been put in a very graphic image by André **Sapir** (2009), a well known expert on European matters, who compared the mostly unknown – because so complicated – European setup with that of the better known US-American one:

> Imagine the US was facing the current crisis with the following situation: only 30 of its 50 states belong to the dollar area; most of the southern states are outside the dollar area and so is New York, home of the US financial centre; the seat of the US government is in Washington, but dollar area chairman Ben Bernanke operates from Pittsburgh and secretary Tim Geithner is mainly governor of Vermont, one of the smallest US states, with a population of roughly half a million.
>
> Absurd? Yet this is exactly what the European Union looks like, with only 16 of its 27 member states belonging to the euro area; most of the eastern states and the UK, home of the EU financial centre, outside the

[10]See below. p.31

> euro area; the seat of the EU institutions in Brussels, but ECB president Jean-Claude Trichet operating from Frankfurt and Eurogroup chairman Jean-Claude Juncker mainly the prime minister of Luxembourg.
>
> The point here is not that the EU should become the United States of Europe, but simply that its current organisation poses major problems ...

There are not only institutional and organisational problems associated with the European reactions to the crisis as described in this quote, however. There are also questions of priority and they emerge also from **Sapir** (2009). When he discusses the necessary actions in face of the current crisis, **Sapir** (2009) has a lengthy list, including what should be done with financial institutions, and with third countries like the Ukraine – but he does not even mention the **E**uropean **E**conomic **R**ecovery **P**lan (EERP). This would be understandable if Sapir's (2009) topic were not "How the EU could stop the global crisis becoming a European problem".

For a European citizen who is aware of the dimension of the current crisis – and anybody who reads the alarming statistics and projections could well be among them – it is disappointing to see the apparent neglect of European expert advisors with which they treat the much debated "stimulus packages". Some experts might believe that they have good reasons for neglecting public demand measures as announced in the context of the EERP. We will discuss this matter below and we will argue in the next sections that downplaying the demand side of the EERP is really a bad advice. Neglect of the EERP as a novel instrument for domestic demand oriented growth might well make the EU to cause "the global crisis becoming a European problem". But for the credibility of EU policy announcements it is even worse when we see that such "expert advice" is just another manifestation of a glaring discrepancy between bombastic rhetoric of the EU's official announcements on the one hand and real actions after the bombastically announced actions on the other hand. Let us take note that when the European Economic Recovery Plan was made public, the **Commission** (2008, p.2) prefaced the document with the statements:

> **The time to act is now**
>
> The real test for European governments and institutions comes when faced with the most difficult of circumstances. At such times, they need to show imagination; they need to show determination; and they need to show flexibility. They need to show that they are in tune with the needs of families and communities across the European Union, that they are equal to the task of finding the right response to the sudden downturn in the prospects for growth and jobs in Europe.
>
> Europe will above all be judged on results. ... The current economic crisis gives another opportunity to show that Europe serves its citizens best when it makes concrete action the touchstone. Europe can make the difference.

After this announcement, it is painful to see what did become of the motto "the time to act is now" in the framework of the European institutions. The supposedly next step after "step (6)" of the above list enumerating the steps involved in formulating the European Economic Recovery Plan was to have

(7) an "European Employment Summit", assembling all the relevant leaders in May 2009

as announced by the European **Commission** (2009, p.2) in a document published at the beginning of March 2009. End of March a Council of Ministers decided to downgrade the Employment Summit to a meeting of a few select EU-leaders and experts to convene in May 2009. When the date arrived, one of the three Prime Ministers who was supposed to come declined to come because of "agenda reasons"[11] It is small wonder that the event did not impress the European public (**euractiv**, 2009):

> Social partners invited to the meeting, however, refused to sign the final document. "There are some responses, but it's not enough," said John Monks, secretary-general of the European Trade Union Confederation (ETUC).
> European social NGOs are also "disappointed and concerned" ... Roshan di Puppo, director of the Social Platform [NGO :] "The social impact of the crisis was not mentioned in the summit conclusions, which are just 'business as usual': increase mobility, increase flexicurity and create a favourable environment for enterprises," she added.

This is not to say that nothing did happen as a response to the extraordinary challenges posed by the recent crisis. There were many isolated public activities, some of which were well documented in the European context (**Mandl** and **Salvatore**, 2009)[12] But the problem is that in the European context the "stimulus packages" which were indeed decided were not pursued with a zest comparable to the one which was documented above in the case of China. This has in part reasons which lie in the extremely complex structure of European politics. But there are also some conceptual economic political reasons which should emerge in the following section 4.5 where we discuss the continuing preference in the EU for supply-side rather than demand-side economic political measures.

4.4. **The European Union "stimulus package" and the G20 context.** It is a commonplace that a global economic crisis requires a global answer in the sense of an answer involving all the important global actors. Since the most important economies and international economic institutions, among the latter in particular the EU[13], have their common forum in the framework of "G20 summits", it is clear that much public attention is focussed on these summits because they reveal the setting and treatment of agendas with potentially far-reaching consequences.

[11]**Willis** (2009): Spanish Prime Minister Jose Luis Rodriguez Zapatero has decided not to attend an employment summit being held in Prague this Thursday (7 May), delivering a further blow to the meeting, which was already downgraded from EU leader-level in March to that of a conference."

[12]See also **Khatiwada** (2009) for a comparison of "stimulus packages" in a global context.

[13]From the G20 homepage (`www.g20.org`): "The G-20 is made up of the finance ministers and central bank governors of 19 countries: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom and the United States of America, and also the European Union who is represented by the rotating Council presidency and the European Central Bank. To ensure global economic fora and institutions work together, the Managing Director of the International Monetary Fund (IMF) and the President of the World Bank, plus the chairs of the International Monetary and Financial Committee and Development Committee of the IMF and World Bank, also participate in G-20 meetings on an ex-officio basis. The G-20 thus brings together important industrial and emerging-market countries from all regions of the world. Together, member countries represent around 90 per cent of global gross national product, 80 per cent of world trade (including EU intra-trade) as well as two-thirds of the world's population. The G-20's economic weight and broad membership gives it a high degree of legitimacy and influence over the management of the global economy and financial system."

At and around the G20 summit in London on April 2, 2009 there was particularly intensive debate about the size and the importance which the different G20 members attribute to the respective "stimulus packages". There was the prior decision, taken at the Washington meeting in November 2008, to "Use fiscal measures to stimulate domestic demand to rapid effect, as appropriate, while maintaining a policy framework conducive to fiscal sustainability." (**G20**, 2008)

The question was now how to act on this decision. How soon is "rapid", how much is "appropriate" and what is "sustainable"? It turned out that answers to all these questions were quite controversial – and they still are controversial.

The G20 summit in London revealed a deep division between the USA and the continental Europeans. Thus, the German Newsmagazine *Der Spiegel* reported (**Volkery**, 2009):

> The EU has made up its mind: Fighting the financial crisis with American-style stimulus plans will not be the model for Europe. At a summit in Brussels this week, European leaders are preparing the party line – and it is to focus on a new financial world order.[14] ... Many were irritated by a recent interview in the Financial Times by Obama's economic advisor Larry Summers, who said the top priority of the G-20 summit would be to boost global demand. ... The US government is seen as a bad advisor in financial matters – the Europeans think its crisis management is suspect.

Figures for some of the respective regional "financial stimuli" were given above already in table 2 in the context of discussing China's "stimulus package". But we find there also figures for the size of the British commitment of 1.5% of GDP and the German commitment which is double that size with 3.4% of GDP. (column before the last in table 2 above). Britain as the host of the G20 summit would have liked to support the US American stance to have rather larger than smaller "stimulus packages". But it is clear that with these comparatively low own contributions to fiscal stimuli Britain could not put negotiating pressures on Germany to exert still stronger commitments although the press was full of reports that the UK government did want the German one to be more expansionary (e.g. **www.guardian.co.uk** 2009). Britain with London as global financial center is traditionally wary of stronger controls of the actions of the financial sector as they were proposed by the continental Europeans. Thus, there is some deep rooted difference in the EU camp itself concerning the appropriate action for answering the crisis. This could impair the EU's impact in the field of financial markets reform in the G20 context.

But it is not just the continental Europeans who would like to press for financial re-regulation after the global financial crisis. There are also some US-American commentators who put now great stress on reforming the global financial system. Thus, Nobel Laureate Joseph J. **Stiglitz** (2009b) declared recently:

[14]See the Coucil Conclusions (**Council**, 2009b, p.16) according to which the EU will press at the G20 summit for "Better regulating financial markets". In particular the EU wants to "Ensure appropriate regulation and oversight of all financial markets, products and participants that may present a systemic risk, without exception and regardless of their country of domicile. This is especially true for private pools of capital, including hedge funds, private equity and alternative investment vehicles." Since many of these are domiciled in the USA, there is going to be considerable lobbying in the USA against this stance of the EU.

> The real failings in the Obama recovery program, however, lie not in the [allegedly insufficient, GMA] stimulus package but in its efforts to revive financial markets.

The well known monetary historian Barry **Eichengreen** (2008) alluded to the good regulatory experience with the World Trade Organization. Its installation was preceded by decades of opposition from the US Senate. This precedent should give perseverance in pursuing Eichengreen's (2008, p.16) proposal for a

> World Financial Organisation akin to the World Trade Organisation. Membership would be obligatory for all countries seeking freedom of access to foreign markets for domestically-chartered financial institutions. The WFO would define obligations for its members; they would have to meet international standards for the supervision and regulation of their financial markets and institutions. It would empower independent panels of wise men to determine whether countries were in compliance with those obligations. Importantly, it would authorize the imposition of sanctions against countries that failed to comply. Other countries would be within their rights to restrict the ability of banks and nonbank financial institutions chartered in the offending country to do business in their markets. This, then, would provide a real incentive to comply.

With the perspective thus outlined by **Eichengreen** (2008), the EU's negotiating position in the G20 context might look a bit 'visionary' but not as being entirely without justification.

But the issues of financial reform vs. fiscal stimuli should not be seen in a controversial vein. These issues should support each other in the attempt to regain a working global economic order and under that perspective we need both, stabilization of demand through "stimulus packages" *and* stabilization of the financial system through oversight and re-regulation.

4.5. **The supply-side bias of the European employment policies .**

4.5.1. *Tactical reasons.* I mentioned in the introduction the shifts in economic political preoccupations of the Western governments from anti-depression to anti-inflation measures, i.e. from Keynesian aggregate demand thinking to Monetarist supply side economics. After the outbreak of the current economic crisis the time has obviously come to move again towards Keynesian aggregate demand positions. The controversies of the EU with the US in the run-up to the G20 summit suggested, however, that the Europeans are somewhat "dragging their feet" in the move back to Keynesian positions. The sorry fate of the European Employment Summit of May 2009 in Prague which was treated above in connection with the implementation of the EERP is a further testimony for the lack of enthusiasm among European politicians for a forceful demand oriented policy.

There thus seems to be a specific bias in European economic policy which gives it a rather different orientation than the one which we can see in the case of China (and similarly in the case of the USA of the Obama administration). This specific European policy orientation may have several reasons. One reason was just discussed, namely that the EU camp reached agreement among themselves that better financial oversight is a necessary pre-condition which must be fulfilled before there can be hope to have again a smooth running of the international economy. Since in the past the USA was very reluctant to accept the idea of stricter control of the financial system, the present position of the EU side can be interpreted as the build-up of a bargaining position. An eventual compromise could then be that the EU would introduce further fiscal stimuli later but only after the USA agreed to better global financial oversight before that. But this rationalization of the European position vis a vis the USA certainly cannot give the complete picture of the noted differences in emphasis.

4.5.2. *The existence of "automatic stabilizers".* A further reason for the current reluctance of the EU members to decide collectively on additional Keynesian policies could be that they are "automatically" more Keynesian than other regions of the world, in particular in comparison to the USA and China. As a commentator in the *New Statesman* recently remarked (**Mason**, 2009):

> There is a rational core to the EU giants' opposition to fiscal stimulus – that their large state sectors and welfare systems will provide "automatic stabilisers" as recession kicks in, obviating the need for extra discretionary spending along US and Chinese lines.

The EU members therefore have for the moment no need to be "discretionary Keynesians". This could be a legitimate reason why they do not follow the USA (and China) to the same extent in *explicitly* implementing further Keynesian policies. The Europeans might claim that *implicitly* they are more Keynesian then others all along.

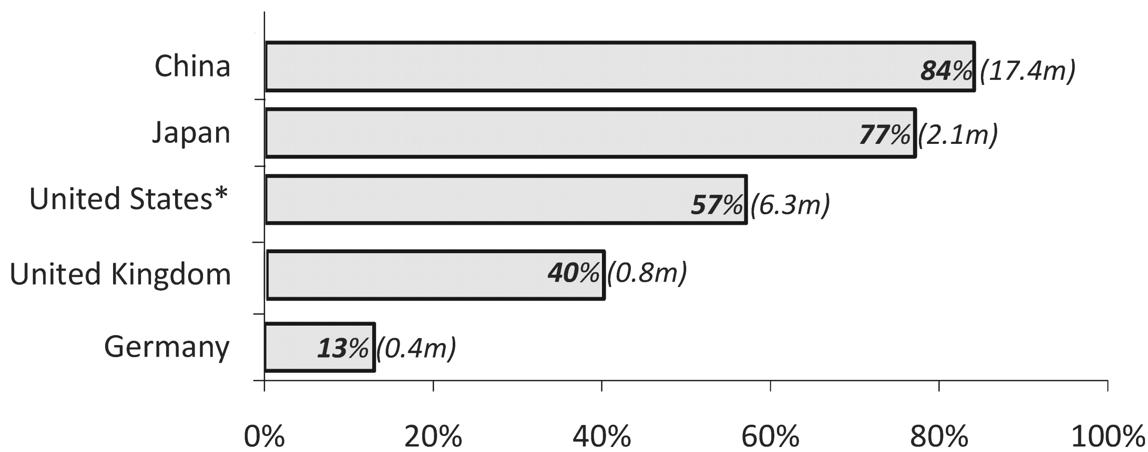

FIGURE 4. Share (and number) of unemployed workers NOT receiving unemployment benefits according to **ILO** (2009, p.18)[15]

This argument could be elaborated with reference to fig.4, but the argument about automatic stabilizers goes beyond just unemployment compensation and covers taxing and expenditures question which go beyond the present scope.[16] But figure 4 shows that in some countries, like Germany, comparatively few workers have to go without benefit payments when they are unemployed. There are other countries where either the definition of unemployed workers is very restricted (e.g. China) or where entitlements to unemployment benefits are very restricted (e.g. USA) so that comparatively few of those who are factually unemployed do get benefits. But benefit payments have to be paid for

[15]For source and qualifications see **ILO** (2009, p.18).

[16]See, e,g, **Auerbach** and **Feenberg** (2000) and for a brief survey **Hughes** (2009).

– either by the lucky ones who continue to receive their customary wages or by taxpayers, social insurance contributors or by creditors of the state in the case of deficit spending. The transfers to the unemployed will be largely spent by them and thus we have under such a regime an "automatic" transfer to sections of the population with a high propensity to consume. Since this – so may be the claim – happens to a large extent "automatically" in many European countries, they do not need to stimulate demand discretionally. It is, of course, a rather involved matter to establish the existence and the magnitude of such "automatic stabilizers". But on the basis of recent research, **Wilson** (2008) did speculate that in the USA the new interest in discretionary economic policy might result from a considerable decrease of "automatic stabilizers"

> The decline in the role of automatic stabilizers [in the USA, GMA] could be part of the explanation for why nonautomatic (discretionary) countercyclical fiscal policy has once again become an important instrument in the fiscal policymaking toolbox.

The decline of these stabilisers had been world-wide according to **Stiglitz** (2009a) due to wide spread "supply-side" oriented changes in economic systems. Nevertheless, there could still be significant remnants in the EU in order to warrant Europeans' relatively low disposition to presently apply discretionary Keynesian policies.

4.5.3. *The persistence of the doctrine of "competitiveness".* An additional and less enlightened reason for Europe's comparable low engagement in Keynesian demand-side politics might be intellectual inertia: after decades of supply-side preoccupation it seems to be difficult to think that for quite some time to come we might have severe problems of bringing our existing capacities to satisfactory use. Thus Jean-Claude **Trichet** (2009, p.5f.), the President of the European Central Bank (ECB) – so to speak the "personification of the Euro" – declared in February 2009 in the face of accelerating global economic downturn and rapidly rising rates of unemployment (emphasis added, GMA):

> Unemployment is a clear concern right now in many parts of the euro area, and we surely do not want to lose human capital or scar a large proportion of the people of working age. As I mentioned before *wage restraint* would help a lot in this respect. More generally, in order to minimise job and output losses related to the current downturn, it is vital that euro area governments and social partners pursue four objectives:
>
> [1] First, wage setting needs to take account of the *competitiveness* and labour market conditions in a responsible and timely manner.
>
> [2] Second, national authorities should pursue courageous policies of *spending restraint* especially in the case of public wages. A prudent fiscal stance should be always in place.
>
> [3] Third, the completion of the Single Market [*inside* the EU territory! GMA] ... Measures that hinder free *competition* and cross-border trade must be avoided. In this context, it is of the utmost importance to resist protectionist measures.
>
> [4] Fourth, in the context of the *Lisbon agenda*, the necessary reforms that enhance *competition* and improve long-term growth prospects in the euro area must be implemented.

According to Trichet's view the order of the day in 2009 is "wage restraint", "spending restraint", "competition". "competitiveness", the "Lisbon agenda" – a term which obviously must now be addressed. But let us register first: at a time when his ECB floods the economy with liquidity, driving down central bank interest rates to record lows (March 5th 2009: 1.5%), and at a time when the European economy is moving ever faster in the downward direction, the ECB-President Trichet declared: "the risk of deflation in Europe is not substantiated" (**Vidaillet**, 2009). In some European quarters there seems to be a considerable lack of perception of the real and mounting demand-side problems challenging the economic survival of many firms and workers. It is understandable that Paul **Mason** (2009), the commentator just quoted, also wrote:

> Like many responses in this crisis, the European stance is traceable to a piece of neoliberal hubris.

This may be substantiated with a few words concerning the often mentioned "Lisbon agenda". Its origin was a proclamation of the European heads of government at the European **Council** (2000) in Lisbon, the capital of Portugal. It stated that within ten years – i.e. by 2010 – the EU had

> "to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion".

The way to do this was to increase European "competitiveness" by a vast amount of individual actions which cannot be covered here. Let us note, however, that the quantification of this aim in the field of employment was

- to reach a general employment rate of 70% of the 15 to 64 year old population,
- to increase the employment/population ratio of women to 60%, and
- to better integrate older persons into the labour market, so that an employment/population ratio of 50% among the 55 to 64 year olds is achieved.

The problem with these aims – and with many other aims of the "LIsbon agenda" – is that they are not covered by the treaties (TEC or TEU). Therefore rather complicated administrative and political mechanisms had to be used which assured that this agenda was followed through in all the member countries in a co-ordinated way.

The pattern of interaction in the context of this "Lisbon agenda" was roughly the one described above in connection with formulating and enacting the EERP (see p.23). The realization of the employment aims involved massive changes in social protection and in the organization of employment agencies. The (hidden) agenda behind the aims to raise the participation rate of women, of old-aged workers and of the population in general was to lower the "reservation wage" of the people in order to give material incentives for all sections of society to enter the labour markets as workers or to enter the goods and services markets as petty entrepreneurs.

This factor-supply and goods-supply oriented agenda was an utter failure as far as economic "dynamics" was concerned. As far as "greater social cohesion" – the associated aim in the Lisbon proclamation – was concerned, the failure is even greater: the share of wages has declined steadily, poverty and the inequality of the distribution of wealth have increased (for some relevant figures see **Collignon** (2008a)). But nevertheless, the officials and the politicians who have now worked almost a decade with the "Lisbon agenda" seem to be convinced that come what may, we need not less of this agenda but more of the same.

The "Lisbon agenda" becomes a heavy burden for the European society when its re-invigoration is advocated in a context which has nothing to do with the premisses on which the formulation of this agenda was founded. The pressing problems of the present days are not about supply but about demand. They do not involve inflation, but deflation. The time of crisis in 2009 is not the time for monetarist supply-side economic policies but rather for Keynesian demand side policies. In 2009 we are in a typical Keynesian "liquidity trap". The ECB proves this by having no qualms about flooding the European economies with liquidity at rock-bottom interest rates – a clear sign that the old customary economic conditions do not apply at this time. Yet, in spite of all the signals of a novel economic crisis, the ECB President calls for the old economic political recipes of wage restraint and expenditure restraint.

The reluctance in some high places of Europe – like in the ECB – to accept the Keynesian prescription of demand measures might be explained with an unimaginative adherence to the outdated "Lisbon agenda". But the people in Europe and in many further countries of the world presently do not experience "natural unemployment", the core unemployment concept of supply side macroeconomics, but they experience an "unnatural" under-utilization of productive plants. We have millions of workers eager to work, earn, and consume – but without jobs. It is not the supply side which causes these troubles. It is problems to bring the obvious latent demand and the dire need of large sections of the population to the millions of suppliers of goods and services who are desperate for enough turnover to save them from bankruptcy and from closure of their factories. We have the specter before us of millions of people fighting for a decent life. To talk about lacking competition or lacking competitiveness in such a case seems to be utterly besides the point.

4.6. **Wrong macroeconomic incentive structures.** One further reason why EU member states are not eager to employ Keynesian expenditure policy could be seen in the Keynesian mechanisms themselves. Let us write the following expression for GDP

$$Y = C_{\mathrm{pr}} + I + G + X - M \tag{3}$$

where Y= GDP, C_{pr}= private consumption, I = gross investment , G= government consumption , X= exports , M=imports (and where X-M=CA as formerly used in equ.(1)). If we now use the Keynesian "propensity to consume" $c \equiv C_{\mathrm{pr}}/Y$ and the "propensity to import" $m \equiv M/Y$, then we can re-write equ.(3) as

$$Y = cY + I + G + X - mY \quad \text{resp.} \quad (1 - c + m)Y = I + G + X \tag{4}$$

We thus get the Keynesian "fiscal multiplier" for additional government expenditure as equ.(5a)

$$a) \ \frac{\Delta Y}{\Delta G} = \frac{1}{s+m} \quad ; \quad b) \ \frac{\Delta Y}{\Delta X} = \frac{1}{s+m} \tag{5}$$

where $s \equiv 1 - c$ is the propensity to save. Equation (5b) shows, however, that there is an identical multiplier for exports X. Thus, if a country (or the EU) – could boost her "competitiveness" on the world market – which means that this country (or the EU) can export more – then she can have the same macroeconomic result as when she enhanced government consumption. Equation (5b) lies behind the EU's decades old drive for "competitiveness" and it lies behind China's "export led growth", her large growth rates being driven until the crisis by very high volumes of exports to the world markets and especially to the USA, as we noted when mentioning the parable of "Chimerica" above. Equation (5 a and b) together show that when there is a dramatic drop in exports ($-\Delta X$) due to the crisis of 2008/9, then a country could stabilize her GDP (or Y) by increasing government spending ($+\Delta G$), as was done quite successfully by China in 2009 and as was done to a lesser extent – and with consequently less impact on growth rates – by the EU's EERP.

This little exercise shows by the way, that a) the "Keynesian" demand policy of "stimulus packages" and b) the supply side policies of "competitiveness drives" are in a way just different sides of the self-same "Keynesian" coin, a) depending on the Keynesian demand multiplier of equ.(5a) and b) depending on the Keynesian export multiplier equ.(5b). But why should the EU be so reluctant to employ the demand multiplier a) and be so insistent on "competitiveness drives" relying on b)? This question can be discussed with the help of a few further considerations based on equ.(5a).

In a country where the propensity to import m is relatively high and the propensity to save is also high, the fiscal multiplier is relatively low. Thus, if in equ.(5a) we had a high savings rate of, say, $s=\frac{1}{2}$ and a high propensity to import of, say, $m=\frac{1}{2}$ then equ.(5 a) gives a fiscal multiplier of 1. If, however, we had a closed economy with $m = 0$ and a low propensity to save of, say $\frac{1}{10}$, then equ.(5 a) would give a fiscal multiplier of 10. In other words: an economy which is open and has a low propensity to consume, like Germany, would get comparatively little additional GDP out of a given increase in government consumption ("stimulus package") because much of the additional demand would not address the domestic economy but foreign economies.

A corollary of this result is that the revenue reflux in an open economy is comparatively low and active fiscal policy is therefore relatively expensive in terms of additional debts incurred. Thus, assume that government consumption G is financed in part by debts D and in part by an income tax of the rate t so that we have

$$G = D + tY \quad \text{resp.} \quad \Delta G = \Delta D + t\Delta Y \tag{6}$$

We thus get

$$1 = \frac{\Delta D}{\Delta G} + t\frac{\Delta Y}{\Delta G} \quad \text{hence, using equ.(5 a)} \quad \frac{\Delta D}{\Delta G} = 1 - t\frac{1}{s+m} \quad . \tag{7}$$

We can now ask: what happens with government debt D if we have a given increase in government expenditure G? The answer depends on the parameter constellation which enters the last term in equ.(7). Suppose we have an incomes tax rate of 30% and an open economy as before with $s = 1/2$, $m = 1/2$. The last term in equ.(7) would then be $-0.3 \times 1 = -30\%$. If we subtract 30% from 1 or 100% by following the last equation in equ.(7), we get a value of 70% which means: a given "stimulus package" ΔG will lead to an increase of government debt ΔD of 70%. The "stimulus package" will burden this particular country with a sizeable additional government debt. But make the same exercise for a country which concentrates its consumption on domestic goods and has no imports. The relevant parameters are now $t = 0.3$, $s = 1/10$, $m = 0$ by assumption. In this case the last term in equ.(7) is $-0.3 \times 10 = -3 = -300\%$. If we proceed again by subtracting this value from 1 resp. from 100% we get a value of -200% which means: a "stimulus package" will lead not to an increase but to a sizeable *decrease* of government debt!

We see from these few algebraic considerations in the Keynesian tradition: a country which is comparatively open to imports (large m) would have a large increase in debts due to active fiscal policy. On the other hand, a closed economy with a high propensity to consume like in the last numerical example, might reduce outstanding government debt by wisely using the fiscal multiplier.

It is probably along such lines of thought that the Chinese expert Jing Linbo whom we quoted at the end of section 3.3, stated that China's public revenue might not be strained but boosted by wise fiscal stimulus measures. This outcome would require a strengthening of domestic demand and a subsequent increase in tax revenue. Our inspection of the realization of the current Chinese "stimulus package" showed that there were indeed a number of characteristics which do correspond to these requirements – introduction of better social protection as means of reducing the propensity for precautionary saving and relative reluctance of the central government to use tax rebates.

It is certainly along the lines of models just outlined that Joseph **Stiglitz** (2009a) stated that one of the problems with active fiscal policy might be that there is a discrepancy between costs and benefits of such policy: in a situation like the present crisis there is considerable benefit to be expected in terms of additional income and employment due to active fiscal policy. The problem is, however, that in a wide open economy these benefits might accrue to a large extent to foreigners and not to the own economy. In such a case there is an incentive to wait for fiscal "stimulus packages" by neighbour economies and to do nothing in this field oneself – especially if the country in question has the ambition to incur little additional public debt.

But this latter strategy is a "free rider" strategy. That country which proposes austerity in the face of a depression – if it acts rationally – waits that other countries do not behave like itself. If others do stimulate demand, then the "free rider" country can benefit of the additional demand in an open international economy and at the same time it can claim that it stands for exceptional stability since this country did not engage in increased government spending. In a way this was the strategy of Germany before the introduction of the Euro. It run comparatively low state deficits and rather austere monetary policies, benefitting from more expansionist policies by her neighbours in the European Common Market.

Germany made it a pre-requisite for her accepting the introduction of the Euro that fiscal austerity rules were introduced in the entire Euro Area. But there is a touch of a tragic self-obstruction in Germany's success to extend its own austerity policy to the rest of the Euro Area, as **Bibow** (2009) recently remarked:

> German economic policy wisdom may have served (West) Germany well in the post-war period until the 1990s. Ironically, it has failed the country exactly in what, in the minds of German policymakers, should have been its greatest hour of glory: the export of the German model to Europe through the euro as Europe's common currency. The German model relies on competitiveness gains through price stability as fueling the export motor of an economy otherwise unassisted by growth-friendly macroeconomic policies.[[17]] Essentially the more difficult part in macroeconomic policy is thereby left to those who have the courtesy to stimulate German exports. Exporting the German model has not only undermined the model's working at home by requiring what are Germany's key export markets to converge

[17] In terms of equ.(5) this means Germany relied on $+\Delta X$ instead of $+\Delta G$ for growth $(+\Delta Y)$

> to the German model. Its export has also created an economic giant that fails to pull its global weight ...

We may now return to Sapir's (2009) question of "How the EU could stop the global crisis becoming a European problem" which we mentioned above. Before the background just outlined, the appropriate answer appears as being: the EU's reaction to the global crisis should not be to make her economic recovery depend too much on the "stimulus packages" being successful in China and in the USA so that EU's exports pick up again. Instead, the EU should rather work towards making her own EERP-package to a project which generates a demand stimulus of equally large dimension as the fiscal stimulus generated in China. The most urgent response of the EU to the crisis of 2008/9 does not require primarily that there are dramatic changes in the EU's institutional setup as Sapir suggested. It requires that her basic economic political philosophy shifts away from the supply side bias embedded in years old commitment of the EU to "competitiveness" and "stability". It should change to an expansionist demand orientation as long as the main problem is to bring about full employment and full capacity utilization.

5. Leadership problems in a post-crisis world

The "stimulus packages" which were envisaged in the G20 context in 2008 and which were enacted in 2009 with rather differing zest in China and in the EU were an outgrowth of the desire not to repeat the same mistakes which aggravated the Great Depression which happened 80 years ago. The Great Depression led to protracted unemployment and deflation, ending the "golden twenties", a splendid era of previous economic boom. The world had learned from that experience that in such a situation it is necessary to stimulate demand in order to stabilize the economy. This generally accepted wisdom was particularly well applied in China. In the course of 2009 it appeared that the vigorous Chinese approach to expanding public demand did bear good fruit in terms of an unexpectedly high growth rate of +8% and a stabilization of rates of unemployment.

But as soon as the specter of deflation and unemployment recedes, the opposite nightmare of inflation and economic chaos haunts the minds of economists. Some of the associated dangers were mentioned in the introductory section above. Increasingly there appear now warnings by economists concerning the sustainability of public finances and again concerning the banking sector, this time in particular concerning the stability of the banks in China, because they financed large parts of the Chinese "stimulus package", the size of which went far beyond the officially announced fiscal volume. Warnings concerning fiscal sustainability are so much the concern in the EU that already in the past she hardly moved in the way of expansionary policies, although her leaders had the good, but meek intention of supplying some macroeconomic stimulus via an EERP. There is the apprehension among economic experts that the future net outcome of the combined reactions of the important world economies will be not new global growth but protracted stagnation and persistent unemployment problems, the banking sector problems remaining unresolved or even bigger than before. Are we thus bound to go through similar long-lasting depressed economic experiences as there were after the old Great Depression?

In his classical study of the Great Depression, Charles **Kindleberger** (1973), in a final chapter, tried to give an explanation not only for the occurrence but also for the persistence of the 1929 depression. His analysis with regard to the persistence boiled down to the statement that there was a lack of leadership in a rather tragic way: one of the major actors of that time, Great Britain, had the will to lead but not the means to act, Great Britain having been heavily indebted due to the costly World War I which lay behind her. The other potential international actor, the USA, did have the international financial means, since the European states were heavily indebted to the USA after World War I. But the USA had no will to act on behalf of the world economy, since they considered an involvement with the European nations as unrewarding, a mood of "isolationism" prevailing in the USA at that time. Thus, the international financial and commercial situation lingered on in stagnation until a new war effort, this time for World War II, generated new demand for manpower and material.

If we think in those categories also when we contemplate the aftermath of the global crisis of 2008/9, then there is indeed the pressing question: from which side are we to expect international leadership *today* so that a similar chain of events can be avoided? In the USA there is certainly the belief that she is the "natural" leader of the world.[18] They still consider themselves as being the world hegemon and as the only world power after the collapse of the Soviet Union. But they are not in a position of financial leadership any more.[19] It is not they who are the creditor for the world, it is the other way round: the USA are heavily indebted to the rest of the world and the compliance with considerations of the well-being of the American economy comes more from the fear of their creditors for the value of their own Dollar-denominated assets rather than from a respect for the US's possibility to be lender of last resort.[20]

The Asian countries hold the majority of Dollar-denominated financial reserves. But they can not be seen as imminent leaders of the world financial system. As a group, they are less strongly united than the members of the European Union and there is little evidence that they contemplate at all to take a leading role in the world economic system as a regional group. Their strong financial reserves position was a defensive one, resulting from the desire to insure against a repetition of the 1997 Asian Crisis. Their main – and rightful – concern seems to be to preserve the value of these dollar denominated assets and not to present themselves as candidates for a benevolent manager of the world financial system, as the USA did when they did take over the leadership role with the 1944 Bretton Woods international monetary system. And there is no single country in the East Asian region that can – or does – aspire to the role of world financial leader in a financial rule-setting context.[21]

This leaves the European Union as potential candidate for leadership in world financial affairs. The EU is about as strong as the USA in terms of GDP (2008: USA $14.334 trillion, EU $15.292 trillion) and stronger in terms of population (USA 310 mio. , EU about 500 mio.). The new currency of 16 of her member countries, the Euro, is not laden

[18]See, e.g. **Hirsh** (2009) who reported for Newsweek about Barack Obama's inaugural address on Jan.20, 2009 under the heading "Obama to World: 'We're Ready to Lead Again' "

[19]See also **Wallerstein** (2008): "the United States . . . achieved full hegemonic dominance in 1945, and has been slowly declining since the 1970s. George W. Bush's follies have transformed a slow decline into a precipitate one. And as of now, we are past any semblance of U.S. hegemony."

[20]It is the Chinese Premier Wen Jiabao who very recently and very outspokenly expressed this very concern about the USA honouring its national debt, see footnote 24 below.

[21]See **Eichengreen** (2008, p.7) "China is not yet in the position to exert the kind of leadership that could be reasonably expected of the United States in 1929. In fact, China has displayed both leadership and restraint: leadership in the application of fiscal stimulus, having announced a big new government spending package in early November 2008, and restraint in managing its portfolio of dollar securities." But see again footnote 24 for indications of potential second thoughts about the latter point.

with the financial problems of the US-Dollar. But at the moment the EU seems to be most concerned with avoiding excessive debts which would follow from large "fiscal stimulus packages". There might be a stalemate evolving between the EU and the USA with each party pursuing different aims as was mentioned above in the context of discussing the G20 forum.

This suggests the tentative conclusion that in so far as mastering the aftermath of the current world economic crisis would require the ordering hand of an economically powerful and generally accepted leader, we might be in 2009 in a similarly unstructured situation as it was at the time of the Great Depression.[22] But history does not repeat itself in an exact manner. An alternative to a repetition of the leaderless protracted economic depression of the 1930ies might today be an intensified international co-operation built more on mutual acceptance than on an expectation for one single leadership. An indication of movement towards a de-nationalisation of the global economic setup is maybe Governor **Zhou** (2009b) Xiaochuan's proposal for de-nationalising reserve assets of central banks, or, more concretely, to replace the US-dollar by a Keynes-inspired monetary unit "Bancor". But even the author of this idea is not confident that it will become reality soon and in this field, too, there is no unanimity among the G20 members.

As far as unemployment is concerned, the essential thing is to re-establish a high and evenly distributed level of macroeconomic demand. Financial institutions do play an important part in achieving this aim. But the most important thing is the economic political conviction that it is not supply which should be economic politicians' main concern but a sufficient level of macroeconomic demand.

6. Concluding remarks

At the onslaught of the crisis of 2008/9, on October 16 2008, Nobel laureate Josef **Stiglitz** (2008) diagnosed: "This crisis is a turning point, not only in the economy, but in our thinking about economics". But Stiglitz is known for his critical views and such a diagnosis might be discounted as opinionated. It is therefore significant that from the neo-liberal camp we read quite similar views. The New York Times reported on October 24, 2008 from a US Congressional hearing under the heading: "Greenspan Concedes Error on Regulation". It referred to one of the most influential former propagators of financial de-regulation, the long-time Federal Reserve Chairman Alan Greenspan and reported that he "admitted that he had put too much faith in the self-correcting power of free markets and had failed to anticipate the self-destructive power" of some of those markets (**Andrews**, 2008). Greenspan was quoted as having said on that occasion: "Those of us who have looked to the self-interest of lending institutions to protect shareholders' equity, myself included, are in a state of shocked disbelief".[23] Next month already, in November 2008,

[22]See also **Jacques** (2009) from the British *New Statesman* who considers it as significant that solutions are (probably vainly) expected from the G20 and not from the smaller G8: "The G20 meeting on 2 April will deliver little . . . If the western countries plus Japan could have sorted out this crisis through the G8, that would certainly have been their preferred route." If they did not take the "preferred route" that could mean, among others, that none of them could exert leadership among themselves.

[23]But, it must be added, the "disbelief" in the self-correcting power of free markets did not last long. The article ended quoting Greenspan's continuing belief in financial market self-restraint *without* much regulation: "Those markets for an indefinite future will be far more restrained than would any currently contemplated new regulatory regime." (**Andrews**, 2008). Thus, on the very occasion on which he admitted to exaggerated credulity in the self-regulatory power of financial markets, he was confident

the international G20 meeting agreed in Washington to use " fiscal measures to stimulate domestic demand to rapid effect" (**G20**, 2008) as quoted above more fully.

This G20-resolution rescinded the former belief in the tenets of the (in)famous "Washington Consensus" of IMF, World Bank and many co-believing economic advisors – in the belief in economic political prescriptions based on the "Chicago liberalism", a mix of monetarism, propagation of fiscal austerity and privatization, and an unconditional belief in the beneficial self-regulatory powers of market systems. The era of deriding Keynesian active employment policy as "dead" ended with a speedy resurrection of Keynesian "stimulus packages" all over the world, some of them with remarkable success, so far. China is a particularly good example for the success of Keynesian demand policy. The European Union has seen less success in stabilizing her economy – and less effort in demand stimulisation. We showed above that the EU made complicated efforts to combine the new "stimulus packages" urged upon the G20 members by common resolutions, with old EU policies of boosting "competitiveness". It might well turn out that the EU's reliance on better world market demand instead of on increased domestic demand might lead to a prolongation of stagnation and high unemployment.

The crisis of 2008/9 brought a new sense of apprehension and caution about global financial markets and about the working of the international monetary system. The unfolding of this crisis showed once more the intricate interaction between financial markets, goods markets, and labour markets. The debt-financed "stimulus packages" which did stabilize output and employment for a while are reason for new apprehensions in this field because they could be a source of new "unperforming" debts. Thus there is the fear that the cure of the consequences of the crisis could lead back to a set of problems which were among the main sources of the crisis of 2008/9 in the first place.

It is therefore important that part of the new G20 consensus is the desire to reform the global financial markets and also the world monetary system. But in spite of good intentions, there has been little fundamental change in this economic area. It is good to have candid confessions of worry about the present monetary system.[24] It is understandable that there are reassurance that worries are not warranted.[25] It would be best to have institutional arrangements that make the stability of the international financial system independent of the promises of great political leaders and of beliefs of Central Bank leaders like Alan Greenspan whom we just quoted. There is the problem of a lacking of international leadership which we discussed in the preceding section. But nevertheless we may hope that in a continuing spirit of global co-operation eventually the current crises and worries will lead us indeed in the direction of significant institutional reforms.

As far as the world monetary system is concerned, the Governor of the People's Bank of China Zhou Xiaochuan explicitly called for a reform of the international monetary

to advise the public to believe in them "for an indefinite future". This is a bad foreboding for all the crisis-inspired projects to subject financial markets to better oversight and stricter regulation.

[24]**China Daily Online** (2009) of March 14 2009 reports that Premier Wen Jiabao declared to be 'worried' and quotes him with the words: "I would like to call on the United States to honor its words, stay a credible nation and ensure the safety of Chinese assets. ... China is indeed the largest creditor of the United States ..." One may wonder whether the Chinese Premier made such remarks just for entertainment's sake.

[25]**People's Daily Online** (2009b) of March 14 2009 " 'Not just the Chinese government, but every investor can have absolute confidence in the soundness of investments in the United States,' Obama said."

system.(**Zhou**, 2009b)[26] The EU, not having the same problems with an over-abundance of US-Dollar denominated reserves is reluctant to follow suit. On the other hand, the EU's banking system – in contrast to the Chinese one – suffered a lot from the many defaults of American banks and other debtors. The EU's pressure is towards better oversight of banks and of financial markets on the global level. But since this is an area where China is less affected she is less eager to act. These differences between China and the EU need not lead to conflict. They could be a good basis for compromise and for eventual co-operation towards a better world financial system.

Thus, in a newly optimistic mood, we may see interesting forebodings of institutional change to the world economic system where hopefully China and the EU might be mutually supportive and benevolent protagonists.

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[26] Governor Zhou called for a new "super-sovereign reserve currency managed by a global institution ", i.e. he called for an abandonment of the US-dollar as reserve currency. We note that in this context **Zhou** (2009b) Xiaochuan alluded several times to John Maynard Keynes – the economist to whom we also referred several times in the above text.

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