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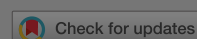
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Articles

NAIRU economics and the Eurozone crisis

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Abstract

Intra-Eurozone current-account imbalances (and divergent external debt positions) cannot be attributed to the deterioration of cost (or price) competitiveness in Europe's periphery vis-à-vis its core. Imbalances were driven by high domestic demand growth in the periphery, which was financed by capital flows from the core. The external finance – following capitalist logic – ended up in non-traded medium-low-tech activities (e.g. construction). This points to a structural problem in pan-European financial integration – which we locate in the economic ideology guiding the EMU: NAIRU economics. We zoom

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elasticities to be much larger (in absolute terms).

3. We use Nechio's ([2011](#)) stylized version of the Taylor-rule, because it has been widely debated (see Darvas and Merler [2013](#); Krugman [2011](#)) and because it uses the unemployment gap as the indicator of the level of economic activity, as we do in this article. We agree with one of the referees that Nechio's Taylor's rule is problematic in its choice of weights, inflation index, and definition of expectations. But we use it here in a descriptive ex-post manner, not as an ex-ante (optimal) prescription. In doing so, we are following a large literature which shows that this simple Taylor rule approximates ECB monetary policy decisions fairly well (Blattner and Margaritov [2010](#); Van Poeck [2010](#)).

4. Of course, we do not subscribe to Taylor's rule and the claim that ECB monetary policy should have been more restrictive. If it had been more restrictive, the Eurozone would have entered a phase of secular stagnation already in the early 2000s – rather than in 2009–2010. But perhaps its foreign imbalances would have been smaller.

5. Absent a central fiscal authority to police the no-bailout rule, this clause lacked credibility.

6. This is an example of Keynesian animal spirits governing financial markets.

7. Atoyan, Jaeger, and Smith ([2012](#)) conclude that push factors (low returns in the core), rather than pull factors (high returns in the destination countries) drove most of the capital flows coming from the Eurozone core.

8. This shows that the crisis was not at all a fiscal crisis, but a private sector (households) debt crisis. As Table 5 shows, governments of Greece, Italy and Spain actually reduced their indebtedness during 2001–2008. The Eurozone crisis is the by-product of the 2008 Financial Crash, which forced governments to bail out their

insolvent banks and their financial institutions. The health of the Eurozone and vice versa.

9. The high-tech sector and the UK, see Buisson et al. (2010).

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10. Bloom, Draca, and Van Reenen ([2011](#)), analysing a panel of up to half a million firms over 1996–2007 in 12 European countries, find that jobs and firm survival rates declined for firms in low-tech sectors, but are relatively protected for firms in high-tech sectors. Technological upgrading in response to increased import competition from China holds the key.
11. A Eurozone break-up is generally expected to lead to an appreciation of the (new) German currency and a drastic depreciation of the currencies of the peripheral economies.
12. The kind of convergence we mean here is exemplified best by the experiences of Belgium and the Netherlands in the 1980s and 1990s. Both countries reformed their wage- and price-setting systems in a painful process, reducing their real wages (relative to Germany) by 20–25%, while avoiding a large devaluation of their currencies and maintaining the hard peg (i.e. monetary union) with the Deutschmark. See Temin and Vines ([2013](#)) for a discussion.
13. The ECB has no accountability on the inflation target, but the consensus is that the ECB is following the Taylor principle (Blattner and Margaritov [2010](#); Fendel and Frenkel [2006](#); van Poeck [2010](#)), adjusting the interest rate in response to real economic activity.
14. We note that the ECB was not designed to act as a Eurozone lender of last resort for banks or as a government-bank for Eurozone sovereigns in distress. This proved a near-fatal design flaw that did unnecessarily escalate the Eurozone crisis (Arestis and Sawyer [2011](#)).
15. We acknowledge that the target is to keep inflation below but close to 2%, which is not exactly the same as to keep it at 2%.
16. See Galí ([2011](#)) for empirical evidence of the interest rate rule for the ECB.

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