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The ECB's Misleading Visualisation of the Euro-Crisis

by Carlo D'Ippoliti

Two recent articles on the *Global Labour Column* deal with the European crisis (one specifically with the Italian case). Economists are still divided over the identification of the ultimate causes of the euro-crisis, but a mix of the two leading theses seems to be the most plausible explanation. On the one hand, the Eurozone is a failing attempt at sharing a common currency (the euro) without having a common governance of the economy. Thus, several economists note that the European Union (EU) "federal" budget is tiny in comparison to the task of managing aggregate demand, while common bonds and mutualisation of public debts is off the table; others question the strictly monetarist mandate of the European Central Bank (ECB), whose Statute (or better the mainstream interpretation of it) prevents the ECB from buying European sovereign bonds and mandates to only focus on the growth of consumer prices. On the other hand, a second explanation looks at the growing divergence of the European economies, in particular the sustained Balance-of-Payments imbalances that produced the accumulation of excessive foreign debt in the deficit countries (derogatorily called GIPSIs after the initials of Greece, Ireland, Portugal, Spain and Italy) and huge, possibly nonperforming loans vis-à-vis the GIPSIs in the 'core' European countries (Germany, the Netherlands, Austria, Finland).

In any case, the answer so far has been made up of three ingredients: 1) a mildly expansionary monetary policy, which is restrictive compared to the Fed's, the Bank of England's or the Bank of Japan's, and was mainly focussed at providing liquidity to the stressed banks; 2) restrictive fiscal policy, which produced such falls in GDP to actually increase the debt-to-GDP ratios of various GIPSIs; 3) "structural reforms", whereby supply-side measures aimed at reducing workers' bargaining power. The rationale of this strategy is to force an adjustment of the deficit countries' balance-of-payments based on the immediate fall of their imports and then, through wage deflation, an increase of their exports.

The relevance of non-price competitiveness

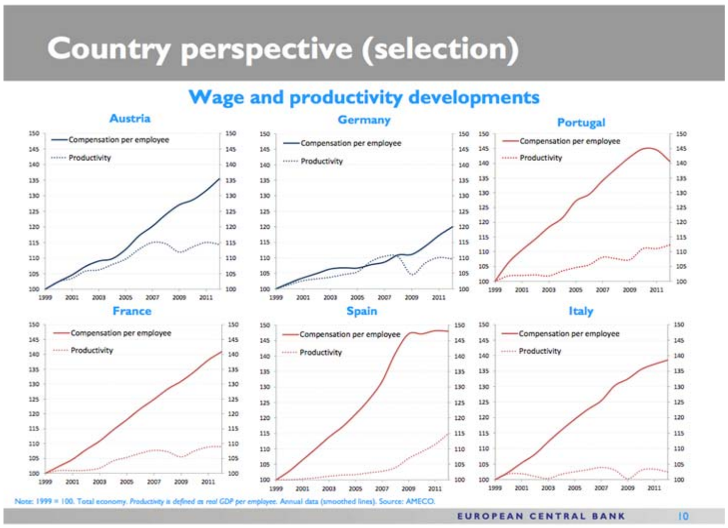
There are *several* good grounds to criticise such strategy (the most obvious being Keynes's famous observation that surplus countries should contribute to balance-of-payments rebalancing). However, it seems convenient to focus here on a specific aspect, and ask: how much should wages in Italy fall, in order for FIAT cars to be competitive with Volkswagen ones? There is no answer of course. In the most industrialised countries such things as the kind and quality of the product or the way it is produced, i.e. 'non-price competitiveness', are normally more relevant than mere labour costs in determining firms' performance. Schumpeter used to write that price competition is like trying to enter a door by knocking on it, while the competitive adoption of new technology is like knocking with a bazooka.

The relevance of non-price competitiveness is indeed recognised by the current European establishment, for example in the "Lisbon Agenda" or the Europe 2020 plan.[1] Yet, the European way to 'recovery', as described above, only seeks to regain cost and price competitiveness on the side of the 'GIPSI' countries. This is partly the consequence of a misleading reading of the data on wages and productivity, which concludes that wages in the 'GIPSIs' grew too much, and it is thus fair now – and economically efficient – that workers pay the highest price of the crisis. The reason is that if wages grow more than average productivity, then unit labour costs grow and price-competitiveness is reduced.

The ECB's position

Unfortunately, this approach is also present in a recent 'lecture' given by Mario Draghi, ECB President, to the Euro Summit of 14 March 2013. Such presentation seems to have taken on a crucial role at the meeting, silencing - according to the *Frankfurter Allgemeine Zeitung* - the Eurozone leaders willing to change the austerity agenda. The ECB has not yet replied to the accusation of having 'massaged the data' by comparing a series expressed in nominal values (wages) with one expressed in real terms (productivity), with the result of visualising wages as inflating exorbitantly. However, even if this major mistake was not true, and both series were expressed in real terms (or both in nominal terms), at least three further remarks may impair Draghi's main argument, based on a series of misleading graphs.

Slide 10 of Mario Draghi's Presentation at the March 2013 Euro Summit



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Let us focus on slide 10 displayed above. There, the annual development from 1999 of two variables is presented: "productivity per employee" and "compensation per employee". The former measures the value of total output divided by the number of employed workers,[2] the latter denotes total labour income divided by the same number of workers. Thus, we have two variables that measure a monetary value and that could be expressed in euros (using the nominal exchange rate for the years before entry into force of the common currency). If we did so, we would obviously find that output per worker is higher than compensation per worker, because part of the value produced must cover firms' fixed costs and provide a profit. In the countries and periods considered in the slide, wages rarely exceed 60% of productivity.[3] Yet, by looking at Mario Draghi's graphs (reproduced above), we get the impression that throughout Europe (even in Germany!) wages have become unbearably high, and we naturally come to agree with 'structural reforms', aimed at dragging down wages.

How did those graphs obtain such an odd result, showing wages remarkably higher than productivity, though they are not? Three technicalities should be noticed here.

1. Both variables are expressed with respect to a "base year", i.e. they both take on value 100 in 1999. However, as we just saw, the two variables do not exhibit the same value in 1999. The reason for showing variables with respect to a base year is to highlight their *rate of growth*, instead of their value. So if Worker A earns 10% of Worker B's wages, and if Worker A's wages double and while those of Worker B remain the same, Worker B still earns a lot more money than Worker A. In other words, rates of change provide useful information on the development of a variable through time, but they are frequently inadequate to compare two separate variables.[4] By contrast, this visualisation of the data magnifies the extent of the increase in unit costs.
2. Even if the point of the slide was to compare the rates of growth of the two variables, a second issue here is the time frame. Why do Draghi's graphs start from 1999, when the very database from which they are taken contains data from as far back as 1960? To focus on the impact of the euro is no adequate answer, because the entry into force of the common currency is only the last step of a decades-long process, through the European Monetary System, the Maastricht Treaty, the Amsterdam agreements, etc. If we look back to 1970s, we find that labour incomes have dramatically fallen as a share of GDP, precisely as a consequence of their lower growth with respect to average productivity.[5]
3. Finally, if we wanted to focus on just the last few years, it would still be useful to put the graphs into context. What cannot be seen from the slide is that nominal wages in several European countries grew more or less in line with prices, that is, the purchasing power of wages stayed constant. What disappointingly lacked was productivity growth. Thus, the kind of policy intervention required to lower unit labour costs is productivity growth, not primarily a reduction of wages.

The EU as a neo-liberal machine

Of course, *one* cannot say that Draghi's graphs or the slides are 'wrong', but certainly they exhibit a strong conservative bias. Given all this, one wonders how it is possible that during the presentation nobody in the Eurozone ministers' staff noticed any of these shortcomings. It seems that the European leaders who are reluctant to pursue a strict austerity agenda may have a hard time coordinating a coherent alternative response, in the face of two centralised institutions (the ECB and the European Commission) pursuing a well-defined pro-austerity agenda with the crucial support of valuable research and data analysis facilities. There is, in a sense, a pro-austerity bias embodied in Europe's very institutional architecture, even abstracting from the actual content of its founding Treaties.

This is but one of the several in-built biases in the European architecture, that make it especially prone to unpopular policies and the neo-liberal ideology. Another one, as Italy's recent experience suggests, is the *de facto* ban on second mandates. It may be sufficient to recall here Mario Monti's sudden change, from a pro-austerity 'technocratic' prime minister (appointed without elections) to a pro-growth politician, when he finally had to run for office. Perhaps, if Eurozone and EU leaders were to run for election, and if they were given the chance to be re-elected, they may feel more compelled to pursue growth-enhancing policies.

1 "On the macroeconomic relevance of non-price competitiveness, interested readers are referred to the famous Thirlwall's Law.

2 Presumably full-time equivalent workers, i.e. adjusting for differences in the average number of hours worked, otherwise one would incorrectly think that workers who work more are more 'productive'.

3 The figure is computed using the same AMECO database used in the presentation for reasons of comparability. For the same reason it refers to the total economy, although it would be more correct to exclude the public sector since there by construction productivity changes roughly equals labour costs changes.

4 Thus, the slide shows that profits in the period considered tended to reduce as a proportion of wages, but from there we do not know anything concerning the aggregate value of profits.

5 One may argue that some rebalancing of the wage and profit shares may be welcome also in light of the interpretations of the crisis as produced, among other things, by growing income inequality.

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