European Economic Government and Wage Policy Coordination

The Eurozone Crisis Calls for Structural Reforms

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- The euro's Greek crisis has triggered a long overdue debate on the structural defects of European economic policy and the imbalances in intra-European trade. It is now time to make good the Maastricht Treaty's shortcomings with regard to the construction of Economic and Monetary Union (EMU).

- The Eurozone needs a European economic government, including the Europeanisation of budget competences in order to be able to operate an effective fiscal policy and prevent overindebtedness on the part of the member states.

- The Eurozone needs European coordination of national wage policies in order to be able to prevent the distortion of competition and major imbalances in intra-European trade, with outright winners and losers. To this end, coordination of European social and tax policies is also needed.

- More cooperation between the EU and Greece would have made it possible to prevent a worsening of the Greek crisis. The country is now being required to implement a drastic austerity policy which makes no sense on either economic or social grounds.

Content

Introduction 2

European Economic and Monetary Union – A Unique Institution 2

Fiscal Policy Defects 2

Wage Policy in Europe and the Development of Foreign Trade 4

Overcoming EMU's Structural Defects: European Economic Government 5

Overcoming EMU's Structural Deficiencies: Wage Policy Coordination 5

The Eurozone's Greek Crisis 6

The Debate on a European Monetary Fund (EMF) 7

Outlook 8

Annex 9

Literature 10

Introduction

Greece's debt crisis and the crisis of the euro have given rise to intense debate on reform of the regulations governing European Economic and Monetary Union (EMU). The proposals tabled range from a toughening up of the Stability and Growth Pact, stricter control of financial speculation and the introduction of a European Monetary Fund to the introduction of a European economic government.

This article takes the position that the crises are primarily the expression of structural deficiencies in the Maastricht Treaty, exemplified by the concentration on monetary policy and the establishment of a system of so-called market states. Only by rebalancing EMU in the form of a European economic government and reform of the system of market states can the crisis be effectively overcome. Little has been said so far about the second aspect of the necessary reforms, namely the coordination of European wage policy, which should also be accompanied by the coordination of social and tax policies (Schieritz 2009). This now seems to be changing, in the form of the other member states' criticism of Germany's trade surpluses and economic policy (Kläsgen, *Süddeutsche Zeitung*, 16 March 2010). Unless this is resolved the Eurozone will soon face another major test.

European Economic and Monetary Union – A Unique Institution

The economic and monetary union set out in the Maastricht Treaty is unique in many respects. In contrast to the common economic and monetary areas in the German *Länder*, in EMU there is no:

- economic government at the federal level which, alongside the central bank, which is responsible for monetary policy, has competence over a common tax policy;
- mechanism for financial redistribution which provides for transfers from the federal level to the member states and/or from the richer to the less developed member states in the event of regional economic imbalances;
- common social security systems at the federal level, which also provide for financial transfers from richer to poorer member states;
- a coordination mechanism for wage policy at the federal level which prevents wage cost related distortions of competition between the member states and, in the medium to long term, provides for the convergence of living standards in the EU; such a mechanism is also lacking with regard to the costs of social security systems and taxes.

The Maastricht Treaty, therefore, represents an attempt to establish an economic and monetary union without creating an effective political union or a proper community based on solidarity. The extreme risk this entails was a constant theme of the various critics of EMU in the debates twenty years ago, and rightly so, as the current problems in the Eurozone indicate.

Arising from EMU's structural deficiencies, above all the shortcomings of European fiscal policy and European wage policy have led to serious problems in recent years, which also contributed to the current Greek crisis.

Fiscal Policy Defects

While competence for monetary policy within the framework of EMU was transferred to the European level, financial policy remains the competence of the member states. As a result, EMU has a pronouncedly asymmetrical structure, with supranational monetary policy, but national financial policy (Dullien/Schwarzer 2009). The Delors plan in preparation for the Maastricht economic and monetary union opted for an asymmetrical structure at the expense of the parallel Europeanisation of monetary and economic policy. With the paradigm shift from Keynesianism to market liberal economic doctrines (supply side approach, monetarism, new classical macroeconomics) the importance of fiscal policy for stabilising the economy waned, while the orientation towards balanced budgets and the lowest possible public spending ratio gained the upper hand. This paradigm shift has come at a price: the EU lacks an economic-policy decision-making centre able effectively to lay down and coordinate member state fiscal policy through control of national budgets and, in cooperation with the ECB, to ensure the right monetary and fiscal policy mix.

The weaknesses of this economic-policy structure have been made readily apparent in the Eurozone, first, by the bursting of the New Economy bubble in 2001, then with the advent of the biggest economic crisis since the

Second World War and, most recently, by Greece's current debt crisis.

In contrast to the USA, from 2001 to 2005 the European Central Bank (ECB) and Eurozone governments did not actively combat economic stagnation by means of countercyclical policies. Growth in the Eurozone, for this reason too, remained behind that in the USA and some other EU states (Denmark, Sweden and the UK) (Bofinger 2009). At the same time, the unequal economic development in the Eurozone (boom in Ireland and Spain, stagnation in Germany and Italy) made it clear that the policy mix being implemented by the ECB and member-state governments was not adequate. Since the ECB's interest rate policy was too expansive for the strong economies of Ireland and Spain but, at the same time, too restrictive for the stagnating economies of Germany and Italy, fiscal policy would have had to rein in the economy in Ireland and Spain through austerity measures and boost it in Germany and Italy via an expansion strategy.

This monetary and fiscal policy mix is not possible in the Eurozone, on the one hand because the EU Treaty and the Regulations on the Stability Pact commit governments one-sidedly to consolidate their budgets and, on the other hand, because there is no European economic-policy body able to prescribe the necessary fiscal policy measures – austerity or expansion – to the member states.

The current world economic crisis, which has hit Europe hard, also casts a harsh light on the shortcomings of the EU's economic policy system. The EU member states' reactions to both the financial market crisis and the economic crisis, at least initially, have been inconsistent and uncoordinated, even conflicting. In particular, in both cases France and Germany were unable to reach a common position on whether this was a crisis affecting Europe as a whole, as well as what measures should be used to combat it, with what scope and when they should be applied. The result is, finally, a range of national rescue packages to overcome the financial market crisis which vary significantly in scope and, above all, the extent of state intervention in the banking system. National economic stimulus packages also differ considerably in terms of their scope, the application of fiscal policy measures and, above all, the date of their adoption. Germany, for example, finally adopted its first, rather meagre economic stimulus package only after strong international criticism and its second in the face of looming isolation in Europe.

The EU will never be able to develop a consistent economic policy with the one-sided orientation of monetary policy towards price stability and the existing institutional structures of fiscal policy, with the member states as decision-making centres. A crisis which affects all EU member states – as the current crisis shows clearly – is inevitably addressed too late, without coordination and with insufficient resources. This serves only to deepen the recession and to draw it out longer than necessary.

The Greek crisis has brought to light another weakness of fiscal policy structures in the European Economic and Monetary Union: the lack of control over member states' budget policies. Since EMU lacks a central federal budget of substance and the member states determine budget policy in the EU decentrally, fears of escalating budget deficits in particular led to the establishment in the Maastricht Treaty of a procedure to prevent excessive deficits. The national debt, based on deficit ratios, must not exceed 60 per cent; net new borrowings must not exceed 3 per cent of GDP; and a no-bail-out clause is supposed to ensure that states in EMU running excessive deficits do not impose on Community solidarity. To underpin these provisions a Stability and Growth Pact was created by means of secondary legislation in a series of Regulations. This Stability Pact has been repeatedly revised in the meantime, making it more flexible, especially in its application.

We now know that the central monitoring of national budgets is extremely difficult as long as the relevant competences are decentralised. This system was unable to prevent Greece's fraudulent acquisition of Eurozone membership by reporting false data about the national debt and net new borrowings. It was also unable to prevent the neoconservative government of Karamanlis from again deceiving Brussels in 2009 by reporting a budget deficit of 6 to 7 per cent when it was in fact 13 per cent.

In summary:

1.Because of the structural deficiencies of the Maastricht Treaty the EU lacks a fiscal policy decision-making centre able to implement a Community economic policy, for example, taking decisive action against a major economic crisis.

2.The asymmetry between monetary policy and fiscal policy in EMU also prevents the EU from achieving a flexible policy mix in the coordination of monetary and budget policy.

3.The available mechanisms for controlling member states' budget policies are unable to prevent member states from pursuing a policy of »make believe« when it comes to compliance with the Maastricht debt criteria – in other words, manipulating data and blatantly deceiving the Community.

Wage Policy in Europe and the Development of Foreign Trade

In an economic and monetary union, in which the member states no longer have the expedient of exchange rate adjustment at their disposal, competition based on wage policy only develops uniformly if national standard wages grow, on average, in a cost-neutral fashion – that is, wage growth rates correspond to the sum of the inflation rate and productivity growth. As a result of the weakening of the trade unions (Platzer 2010) and intensified intra-European competition for business relocations, for over twenty-five years no EU state has been able to implement such a cost-neutral policy; rather, there has been a redistribution in favour of profit income everywhere (Fritsche 2009). To be sure, this process is uneven, including in the Eurozone. Competitive conditions are therefore changing in EMU on the basis of wage costs. Leading the way with regard to the reduction of real wage costs is Germany, which fell by six percentage points between 2000 and 2008, while in the 16 states of the Eurozone the figure was 3 per cent, on average (European Commission 2009: 100). As far as unit labour costs are concerned, which many economists regard as more relevant in terms of competition, according to the data, in Germany they had risen by only 3 percentage points, to 103 in 2008 from the basis year of 2000 (100), while in the Eurozone the figure was 119 (Greece reached 129, Spain 127, Italy 126, Portugal 123 and France 117). Export weighted, nominal unit labour costs in Germany in relation to 35 industrialised countries fell from 2000 to 2008 to 98, while in the Eurozone they rose to 124 (Greece 117, Spain 119, Italy 123, Portugal 114 and France 114) (European Commission 2009: 102).

Since the foreign trade of EU states is predominantly intra-EU trade, the improvement in Germany's competitiveness due to wage costs has been reflected in ever larger current account surpluses in relation to its European partner countries. According to IMF data, Germany's current account surplus was already 7.5 per cent of GDP in 2007. It has risen continuously since 2000, when it was in balance. In contrast, the indicators of other countries deteriorated between 2000 and 2007: in France from +1.9 to –1.0; in Italy from –0.1 to –2.4; in Spain from –3.9 to –10.2; and in Greece from –7.2 to –14.1. Portugal has been unable to substantially reduce its current account deficit, which was already high in 2000, at 9.9 per cent: in 2007 it still stood at 9.5 per cent (IMF 2009: Table A11). Besides Germany, during the period in question only the Netherlands and Austria, among the Eurozone states, registered an improvement in their balance of payments.

Yet another indicator shows the intra-European shifts in favour of Germany: the proportion of the exports of goods and services of EU-15 countries in the EU area rose from 19 to 20 per cent of GDP, on average, between 2000 and 2008; in Germany, it rose from 19 to 25 per cent, which was well above average (European Commission 2009: 108).

Certainly, other factors than wage costs affect the development of current account balances (for example, the comparative growth rates of economies), but the figures cited above clearly indicate the wage-cost related shifts in intra-European competitiveness in favour of Germany. In this way, Germany is exporting unemployment to its European neighbours, who in turn are exporting employment to Germany.

In the long term, the Eurozone cannot withstand these imbalances in the distribution of the winners and losers of integration. The accumulation of employment gains in Germany and the concentration of employment losses in the Southern countries of the Eurozone is increasingly undermining the basis of their existence.

Overcoming EMU's Structural Defects: European Economic Government

The EU does not have a large budget at its disposal. It amounts to only around 1 per cent of EU-27 GDP, which means that the EU cannot pursue any kind of fiscal policy. Transfer of fiscal policy competence to the Community level must therefore involve giving the EU the right to manage the parameters of member states' budget policies. Precisely this was foreseen in the first plan for the introduction of economic and monetary union in the European Community, the Werner Plan, in the early 1970s. According to the Plan, »the determination of variations in the volume of budgets, the size of the balance and the methods of financing deficits or utilizing any surpluses … will be decided at the Community level«. This formulation meant nothing less than the establishment of a European economic government which would decisively shape the Community's economic policy and, within the framework of its fiscal policy responsibility, also lay down the basic orientation of national budgets.

If the EU possessed this competence, all three of EMU's fiscal policy structural defects could be avoided. The Community could, in cooperation with the ECB, pursue a flexible policy mix in monetary and fiscal policy, taking into account specific circumstances in the economic situation of the member states. The EU could implement a countercyclical economic policy for the Community as a whole. Finally, debt, both in the Community as a whole and in individual member states, could be managed more responsibly. No state would be able to incur excessive debt. Debt crises, such as the one in Greece, would no longer be possible. Overall management of budgets would be the competence of the European Union. In addition, the introduction of European economic government would make it possible to do a lot more to get the member states to implement the »Europe 2020« strategy in place of the ultimately unsuccessful »Lisbon Strategy«.

Since, at present, the Community does not have a democratically elected government, the question arises of where this competence of economic government would be established. Within the current institutional structures of the EU, in my opinion the following arrangements for economic government seem appropriate: the European Commission would work out the basic outlines of economic policy, including laying down parameters for the national budgets of the member states. These basic outlines would have to be adopted by the Council, in the form of the Council of Economic and Finance Ministers (Ecofin), by a so-called »double majority« (majority of both the member states and the population of the EU), as well as approved by the European Parliament by an absolute majority (»ordinary legislative procedure«).

Against this transfer of competence to the EU the objections could be raised that neither the Commission nor the European Parliament have sufficient democratic legitimacy and that it constitutes a grave infringement of the sovereign rights of the member states. However, the current construction of EMU arising from the Maastricht Treaty already contains possibilities for such interference with national sovereign rights (the 3 per cent and 60 per cent convergence criteria), while the Stability and Growth Pact provides for considerable opportunities to intervene in member state budgets. In its so-called »Maastricht judgment« the German Constitutional Court declared these structures to be constitutional, as a result of which it cannot now be argued that the establishment of economic government at the European level would infringe the Basic Law. Moreover, European economic government should also serve precisely to annul or cure the numerous socio-economic defects of the current EMU structure and which seriously impair national sovereign rights, for example, the limitations on implementing a coherent national economic policy.

Overcoming EMU's Structural Deficiencies: Wage Policy Coordination

The structural deficiencies of wage policy in EMU could also be rectified by more European competence. EMU's neoliberal sages sought quite consciously to create a system of market states which would exert downward pressure on national social security systems, national wage costs and national taxes via the mechanisms of competition (Busch 1994). This has succeeded to the extent that social spending, corporate taxation and wages have been reduced in most EU states in relation to GDP or productivity. However, those responsible for this order have overlooked the fact that these reduction processes do not necessarily take place to the same extent and all at once, as a result of which in the meantime considerable distortions of competition can build up. With regard to wage policy, it was shown above that, since 2000, this has led to significant shifts in the trade in goods and services between member states in the Eurozone. If this unexploded bomb within the EU is to be defused, national wage policies must be coordinated at the European level. The European trade unions have striven, since the Doorn Declaration of 1998 and the adoption of coordination guidelines by various European branch federations, to prevent wage dumping in the EU. The trade union federations in Belgium, Germany, Luxembourg and the Netherlands agreed in Doorn to the cross-border coordination of wage policies. As a rule of thumb it was agreed that national wage agreements should realise at least the sum of price and productivity developments.

Another important stage towards European wage coordination was the adoption of a coordination rule by the European Metalworkers' Federation (EMF), also in 1998. This calls on member federations to base their national wage policies roughly on the formula »inflation rate plus productivity increase«. Implementation of this guideline would keep things constant with regard to, at national level, distribution and, at European level, competition. Gradually, all important European branch trade union federations have taken up the EMF's coordination approach, eventually including the European Trade Union Confederation (ETUC), in a number of policy decisions (Schulten 2004). Their implementation has so far foundered on the interests of the employers' federations and the weakness of the trade unions. The EU should commit itself to the establishment of a European coordination mechanism, for example, under the guidance of the European Commission, because this would contribute significantly to the stabilisation of the Eurozone. With the accession of further states from Central and Eastern Europe (CEE) to the monetary union such wage coordination is imperative, although there can be no question of a freedom to form coalitions and an effective collective negotiation system in the CEE countries. In addition, all 27 member states should introduce a minimum wage, defined at the European level. This should amount to 60 per cent of the average wage in the respective member state. As a first step, a minimum wage of 50 per cent could be agreed upon (ver.di 2008).

European coordination should also be contemplated for the two other important location variables, social spending and corporate taxation. For example, the Social Stability Pact which has often been invoked in the political debate could be brought into play for the sake of the welfare state. Furthermore, in order to clamp down on escalating tax dumping in the EU, besides introducing a common corporate tax base, agreement is necessary on minimum rates for company taxes. In the continued absence of such coordination efforts alternative balancing rules must be considered, such as fiscal equalisation, which should take effect on reaching a certain level of current account imbalances, based on cost distortions between the member states.

The Eurozone's Greek Crisis

The Eurozone Greek crisis, in the course of which risk premiums for Greek government bonds have risen sharply and the euro has fallen on the currency markets, can be traced back to a series of internal and external factors, partially related to EMU's structural defects. The internal factors in the Greek crisis include, to start with, the above-average financing deficit in the context of the Euro-group and Greece's above-average government debt ratio. In comparative terms, however, the main cause of the financing gap is not above-average government spending, but the above-average government revenue shortfall. This can be attributed primarily to the low level of tax compliance among the Greek population, the poor organisation of the tax administration and widespread corruption. Among the internal causes of the escalation of the crisis one might mention the fact that the Greek government long left the EU in the dark about the true level of the deficit and the national debt, utilising various accounting tricks to conceal its plight. The external factors in the emergence of the Greek crisis include, on the one hand, the effects of the international economic and financial crisis, which in Greece too pushed up the budget deficit and, on the other hand, the loss of international competitiveness, although this was to a considerable extent due to German wage policy (see above).

The crisis came to a head when international financial speculators bet on Greece going bankrupt and exiting the Eurozone, which contributed to an increase in interest rate differentials to Greece's detriment and a strong devaluation of the euro. The international community's lack of confidence in the statistical data put out by the Greek government and the initial hesitation of EU member states to support Greece financially in the crisis were further onerous factors which intensified the crisis.

In this situation, the Greek government – apart from anything else, in response to increasing international pressure – presented a drastic rescue package, which involved boosting revenue and cutting spending. The government's plan is to reduce the financing deficit by 4 percentage points in 2010 and to bring it down from today's 13 per cent to 3 per cent by 2012. Comparatively speaking, in the German context this would correspond to financial intervention in 2010 alone of around 100 billion euros, which is considerably less than the sum (60 billion euros) which Germany wishes to raise in six years, between 2011 and 2016, on the basis of the so-called »debt brake« (*Schuldenbremse*). Greece therefore faces a Herculean task which no other EU state has previously managed. Macroeconomically, this harsh austerity policy – judged perfectly right and proper from various political angles in the EU – makes no sense, since it will serve only to heighten the country's growth crisis and obstruct the course of its consolidation. In recent years, Portugal has found out that public cost-cutting of this kind can mire a country in sustained stagnation. It should also be noted that many of the EU states, including Germany, which have forced Greece into taking these harsh measures are pursuing a more moderate consolidation policy at home on the grounds that economic recession must first be overcome before cutbacks can be introduced.

Finally, the Greek government's cost-cutting programme is socially unbalanced. Public sector wage cuts, social security cutbacks and VAT rises fall disproportionately on those in the low and middle income brackets. There is no sign of those in the upper income and wealth brackets in Greece being asked to shoulder more of the burden. Trade union protests against the government's drastic austerity programme are therefore understandable from an economic and social standpoint.

In light of the various internal and external causes of the Greek crisis it would have been more appropriate if the EU and Greece had developed a joint strategy. The Greek government would have been able to declare its portion of the responsibility for the disaster and the EU – apart from anything else, on account of EMU's structural defects – ought to have supported Greece financially, in whatever form. On this basis, a medium-term consolidation plan could have been developed, including comprehensive economic and social structural reforms, which would not have choked off economic growth and would have relieved lower income groups of some of the burden, transferring more of it to the upper income strata. Such a package, if introduced early enough, would have placated the international financial markets, alleviated tensions between the EU and Greece and, based on joint responsibility, boosted the legitimacy of the rescue plan, both internally and externally.

The Debate on a European Monetary Fund (EMF)

In reaction to the Greek crisis, the establishment of an EMF is currently being debated in the EU. At present, two variants are on the table (Ohanian/Beyerle, in *Financial Times Deutschland*, 11 March 2010). Daniel Gros (CEPS) and Thomas Mayer (Deutsche Bank) have put forward an approach which envisages the establishment of a fund which, in essence, would be funded from penalties imposed on member states running deficits which exceed the Maastricht debt limits. Countries which have paid into the EMF would, in the event of a debt crisis, be helped indirectly by the use of EMF funds to purchase their government bonds. According to this proposal, sanctions could be stepped up by barring access to the EU structural fund for indebted countries. In the worst case, this approach also envisages regulated insolvency proceedings for the state in question.

A second EMF variant – on which the German Finance Ministry is supposed to be working – is modelled on the IMF. Under this plan, all member states pay into the fund in accordance with their economic level. In the event of a crisis, EMF loans can be made available to member states, the allocation of which would be tied to agreement on a strict adjustment programme for the country in question. Some members of the ECB have expressed strong reservations about these ideas, because they consider them to represent an open invitation to deficit-endangered states to take on even more borrowing. On this basis, the EMF plans would be counterproductive.

Since the »wait and see« approach to the Greek crisis taken by EU states so far in many respects – fuelling speculation and pressing for an over-harsh austerity programme – has only exacerbated the problems, a European IMF which could grant loans to a deficit country (and thereby circumvent the Maastricht Treaty's no-bailout rule) is certainly worth thinking about. Having said that, significant concerns have been identified with regard to the introduction of a fund on the Gros–Mayer model. This approach ultimately comes down to a stiffening of the Stability and Growth Pact. Its strict sanctions would serve to intensify crises and its rigid rules would deprive states of the possibility of combating economic crises using countercyclical measures.

Basically, it can be objected to the idea of an EMF that by establishing a European economic government, with the competence to control member states' budgets at the European level, it would be possible from the outset to avoid the problems which a Fund could tackle only in retrospect. A European budgetary policy within the framework of economic government would permit only such debts as would make sense for combating crises or other macroeconomic considerations.

Outlook

The European Union should take the euro's Greek crisis as an opportunity to rectify the structural defects of Maastricht's economic and monetary union. Although it would be right and proper to constrain (Gabriel/Rasmussen/Schulz 2010) destabilising financial market speculation by banning certain instruments – such as short selling and credit default swaps – and a European IMF could help to combat debt crises after the event, it would be better to tackle the problem at its root by introducing a European economic government. Besides helping to avoid debt crises, this would have the advantage of finally providing the EU with the instrument of a European fiscal policy which would make it possible to conduct a consistent economic policy. Furthermore, the system of market states, which generates conflicting employment effects in the EU, should be abolished by means of European coordination of wage, social and tax policies (Busch 2005). Only through these two structural reforms could lasting stability be conferred on European economic and monetary union.

Against the argument that the EU member states are simply not ready for such far-reaching reforms it can be countered that the structural defects of the Maastricht EMU threatens to tear the EU asunder. Any attempt to stabilise EMU requires further decisive steps in the direction of political union. Without an economic government, without mechanisms of fiscal equalisation and without coordination of wage, social and tax policies at the European level EMU will not survive. The authors of the Werner Plan on the establishment of an economic and monetary union in the 1970s were aware of this. The Delors Plan, on which the Maastricht EMU was based, thought that these fundamental considerations could be ignored. The pain generated by the current crises in the Eurozone shows that this was a mistake.

Annex

Development of unit wage costs, 2008		
Countries	**Nominal unit wage costs**	**Export weighted nominal unit wage costs**
Germany	103	98
France	119	114
Greece	129	117
Italy	126	123
Portugal	123	114
Spain	127	119
Eurozone	119	124

Trade balance		
Countries	**2000**	**2007**
Germany	–0.5	7.5
France	1.9	–1.0
Greece	–7.2	–14.1
Italy	–0.1	–2.4
Portugal	–9.9	–9.5
Spain	–3.9	–10.2

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