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NEETs, North South Divergence and Economic Security in the Euro Area in the Aftermath of the Crisis

Introduction

The euro was intended to bring more economic and political convergence between European countries. This was the main promise of the French Monetarists during the founding debate on European monetary integration, as well as European leaders who decided to permanently fix exchange rates and introduce the euro. Moving forward on the path towards "ever closer union" was the greatest hope of both the architects of the common currency and its political supporters.

However, as a result of the eurozone crisis, European countries actually diverged from each other. The main argument of this paper is straightforward: the financial and banking crisis in the euro area gave rise to the dangerous divide between the core "surplus" countries in the north and peripheral "deficit" countries in the south. In this paper, I examine this divergence by looking at one crucial indicator: the number of young people who are unemployed and inactive (NEET) in the northern and southern countries of the eurozone, before and after the financial crisis.

I follow the convention adopted in the literature and identify the core of the eurozone as Austria, Finland, Germany, the Netherlands and Luxembourg. Alternatively, I refer to this group as "northern countries," "coordinated market economies"[2] (CMEs) or "surplus countries." I consider Greece, Spain, Italy, Portugal and Ireland to be at the periphery of the eurozone. I also refer to this group as "southern countries," "mixed market economies" (MMEs) or "deficit countries."

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[2] On the distinction between coordinated and liberal market economies see: Hall, Soskice, 2001; Hall, 2014; Hall, 2018.

With regard to Ireland, an important clarification is needed: Ireland is obviously not in the south of Europe, and in terms of its economic profile, it has some characteristics of the liberal market economy (LME). However, in the literature on the eurozone crisis, Ireland is usually described alongside Greece, Spain, Italy and Portugal as "the south" due to its strong exposure to the crisis in its first phase and its substantial housing bubble (Pisani-Ferry, 2014; Matthijs, 2016; Hall, 2018; Mody, 2018). This approach has only been strengthened by the international financial press and the widespread use of the acronym "PIIGS," which stands for Portugal, Italy, Ireland, Greece and Spain. Finally, I treat Belgium and France as the centre of the eurozone.

The paper proceeds in three sections. The first section looks at the original arguments made by the euro's intellectual forefathers and the founding debate between German Economists and French Monetarists in order to analyse how the common currency was framed as an instrument for convergence, peace and stability on the Old Continent. Section two examines north/south divergence in the eurozone after the euro crisis by looking at one crucial indicator: the number of NEETs ("Not in Employment, Education or Training") in five northern and five southern countries of the eurozone. Section three discusses the impact of the eurozone crisis on economic security and ongoing political disagreements within the EMU with regard to future reform of the euro.

1. The euro as an instrument for convergence, peace and stability

The euro was presented as an instrument to bring about more convergence between European countries. This was the hope of many intellectuals, technocrats and politicians.

Among the main architects of the euro were Robert Triffin, Robert Marjolin, Raymond Barre, Pierre Werner, Roy Jenkins, Hans Tietmeyer, Karl-Otto Pöhl, Tommaso Padoa-Schioppa, Jacques Delors and Alexandre Lamfalussy. They were not in any way a homogenous group, although they had some things in common. Most of the intellectual architects of the euro had deep personal memories of the First World War and the Great Depression in the 1930s (Dyson, Maes, 2016) and wanted to escape the horrors and political turmoil of the first half of the 20th century (Szász, 1999). They grew up during the pinnacle of the postwar golden era and the rise of the welfare state (see more in: Marglin, Schor, 1992), and

had observed how European nation states had created what Paul Collier (2018) referred to as an unprecedented array of reciprocal obligations in a magnificent epoch of ethical purpose. They saw the first steps towards European integration, the European Coal and Steel Community and the European Economic Community, as instruments of strengthening the nation state (Milward, 2000; Judt, 2005).

In the second half of the 20th century, they experienced the events of the crisis decade of the 1970s (see more: Hobsbawm, 1995) and lived through the economic turmoil after the oil shocks, which resulted in stagflation and the collapse of the Bretton Woods system (McNamara, 1998). Many of them conceived of the future European currency union as a smaller Bretton Woods on a regional scale. In the early 1990s, the reunification of Germany only strengthened their dream of a United Europe (see more in: Ash, 1994). They perceived further unification of Europe resulting from the introduction of the euro as the next necessary step after the reunification of the Federal Republic of Germany (West Germany) and the German Democratic Republic (East Germany). They were filled with a yearning for peace and economic security, and hoped that euro would fulfil this goal.

In policy circles, the promise of economic convergence resulting from monetary integration and fixed exchange rates appeared as early as the 1970s, sparked by the publication of Werner Report (Werner, 1970; Kaldor, 1978). The founding debate between European Monetarists[3] and Economists gave rise to the notion of a common currency as an instrument for deeper political integration. Monetarists believed that the establishment of monetary rules and single currency would lay the ground for general economic convergence and ultimately closer political cooperation between European nations (James, 2012). For them, the right way to achieve economic convergence lay in a common approach to monetary issues. Monetarists agreed that there is a problem with the financial disequilibrium between the European core and periphery, but they perceived a currency union as a tool to close this gap. They also assumed more political cooperation in the form of stronger "surplus" countries supporting weaker nations through currency intervention and the pooling of foreign exchange reserves. Monetarists were especially influential within the French, Belgian and Luxem-

[3] In the context of the European debate on the EMU, the term "Monetarists" means something completely different than the school of economic thought founded by the Chicago economics professor and Nobel-prize winning economist Milton Friedman.

bourgish administrations, but also in European institutions, in particular the European Commission (Marsh, 2009). Technocrats working for European institutions to a large extent shared the beliefs of the euro's architects (see more in: European Commission, 1990).

Among the most prominent Monetarists in this debate was Robert Triffin, a Belgian-American economist and policy adviser to Jean Monnet and the European Commission (Maes, Bussière, 2016). In 1957, in his book *Europe and the Money Muddle*, Triffin outlined what would soon become a key argument of the monetarist camp in the debate on the Economic and Monetary Union (EMU): "monetary unification would not require, in any manner, a full unification of national levels of prices, costs, wages, productivity, or living standards (…) The problem of monetary unification is therefore a political rather than an economic problem" (Triffin, 1957, p. 288). For Triffin, convergence in terms of crucial economic indicators was not a necessary precondition for a currency union; rather, convergence was supposed to come afterwards, as a direct result of monetary unification. Another architect of the European single currency, the Italian banker, economist and Minister of Economy and Finances (2006–2008) Thommaso Padoa-Schioppa saw monetary integration as an instrument to build a genuine and multi-layered federal system in Europe (Masini, 2016). For him, EMU was not a goal in its own right, but rather a necessary step on the path towards a system of shared sovereignties.

The German elites never subscribed to the French notion that monetary integration would be the magic wand that would generate convergence at first in national budgets, growth rates and incomes, and then in living standards among European countries (Sinn, 2014). They were proud of the deutschmark (D-mark) and deeply sceptical towards the euro (Marsh, 1993). In the opinion of the German Bundesbank, the common currency should be the culmination of the integration of the continent – the final step on the path to the European integration, rather than a means to achieve it. The euro should be the last stage in a long process of convergence between European economies, which would eventually lead to political union. This concept was known in Germany as a *Krönungstheorie* ("crowning theory").

Although, on the face of it, the Economists/Monetarists debate looked like a minor disagreement on the right sequence of steps towards the common currency, in essence it was a fundamental conflict about the most appropriate vision of the political economy of monetary cooperation and European integration in general.

2. North/South divergence in the euro area

On its first major anniversary, the euro seemed to be a success story (Maćkowiak et al., 2009). Ten years after its introduction, the European single currency was thought to have proved French Monetarists right and the sceptics wrong. In June 2008, the president of the European Central Bank, Jean Claude-Trichet, announced that the euro had been a remarkable success (Trichet, 2008). In the view of some observers, deep scepticism towards the euro on the part of most US economists had been proved wrong by history. American analysts who warned that EMU countries were far from an optimum currency area[4] supposedly used a static, ahistorical approach by comparing the fully-fledged US monetary union with Europe prior to monetary unification, and ignored the evolutionary dimension of the EMU (Jonung, Drea, 2009).

On closer inspection however, after its first decade, the euro hardly looked like an unequivocally successful venture. Below the surface of the booming housing market and rising living standards in the south, dangerous imbalances of a potentially explosive nature were building. Germany and a few other northern countries had spent a decade implementing labour market reforms, restricting wage increases and improving international competitiveness (Hassel, 2014; Fratzscher, 2018). Their largest companies had also moved large parts of their production chains to low-cost locations in Eastern Europe. At the same time, the southern countries lagged behind in implementing structural supply-side reforms and experienced an increase in labour costs, in particular in the non-traded sectors of their economies, above productivity growth (Johnston et al., 2014).

In part this divergence was home-grown. The European single currency area is an incomplete monetary union, in which each member country maintains its own independent budgetary policy (De Grauwe, 2016). In such a union, a one-size-fits-none interest rate might contribute to serious macroeconomic dislocations. The core problem lies in the fact that a member state which is under threat of deflation needs a different interest rate from a country with an inflation level significantly above the ECB's inflation target (Skrzypczyńska, 2012). The role of monetary policy should be to respond to these divergent needs; that is, to prevent the boom from becoming unsustainable and to minimise the pain of the

[4] For the pioneering work on the optimum currency area (OCA) see: Mundell, 1961. See also: Wojtyna, 1998.

recession (Friedman, 1968). However, in the euro area, the ECB cannot have two different interest rates.

As a result, monetary policy in the eurozone did not mitigate the boom, especially in the period 2004–2007. The ECB's main policy rate (the main refinancing operations rate; MRO rate) fitted a few northern countries well but was generally too high for Germany and much too low for southern economies (Vermeiren, 2017). However, much of this divergence was driven by global forces. In the words of Martin Sandbu (2017, p. 24), "the euro had the great misfortune of being born into the greatest private credit bubble of all time." What happened in the construction sector of many southern economies to a large extent resembled the housing bubble in Florida and California before the credit crunch in 2007 (Bayoumi, 2017; Tooze, 2018). In particular, the Spanish and Irish economies were brought to the verge of collapse, not due to too much government spending but through private credit bubbles (Royo, 2013).

Taken as a group, the eurozone countries did poorly against the backdrop of other economies in the first decade of the 21st century. In 2000–2010, the world economy grew by 43%, while eurozone members grew by 12% (Sinn, 2014). The weakest growth was found among the large regions. Even before the crisis, the euro had not brought any significant boost to economic growth (Stiglitz, 2017; Kawalec, Pytlarczyk, 2016). It neither fostered significant economic nor political convergence between European countries.

When the global financial crisis hit, the euro area slid into recession. At first, it seemed that European leaders were trying to put the blame solely on the US financial markets, and to downplay the significance of the crisis and its potential impact on the European economy (Tooze, 2018). The German policy elite saw the financial crisis above all as a crisis of Anglo-Saxon capitalism, which demonstrated the misguided US focus on the new economy and financial services[5] (Kundnani, 2015).

European countries were unprepared to face the North Atlantic global financial crisis and its spillover in the form of the banking and debt crisis in the eurozone. The result was the first "real" crisis in the EU (Parsons, Matthijs, 2015) – a prolonged and systemic recession that put the

[5] This view is very convenient for many European politicians, since it focuses solely on the malpractice of US financial markets while ignoring the involvement of many European banks (like Deutsche Bank and Commerzbank) in the securitisation pipeline and risky subprime mortgages on the US housing market. See more in: Tooze, 2018; Bayoumi, 2017.

whole European project in danger. Instead of the promised convergence, as a consequence of the eurozone crisis the European countries actually diverged from each other. What were the most worrisome symptoms of this divergence?

In this part of the paper, I look at the number of NEETs in the northern and southern countries of the eurozone. The figures below present the numbers of NEETs in twelve eurozone member states. NEETs stands for "Not in Employment, Education or Training." It is a popular term for young people who are unemployed and inactive. The "unemployed" are usually defined as people who are looking for a job but cannot find one. The "inactive" are not looking for a job and are not in an educational or training program. The measure presented below includes young people between 15 and 34 years old. This wide definition allows for the fact that young people remain in education for longer, and includes the beginning of family formation (OECD, 2016). The time frame is 2008–2017. 2008 was the first year of the global financial crisis. The most recent data in the Eurostat database are from 2017.

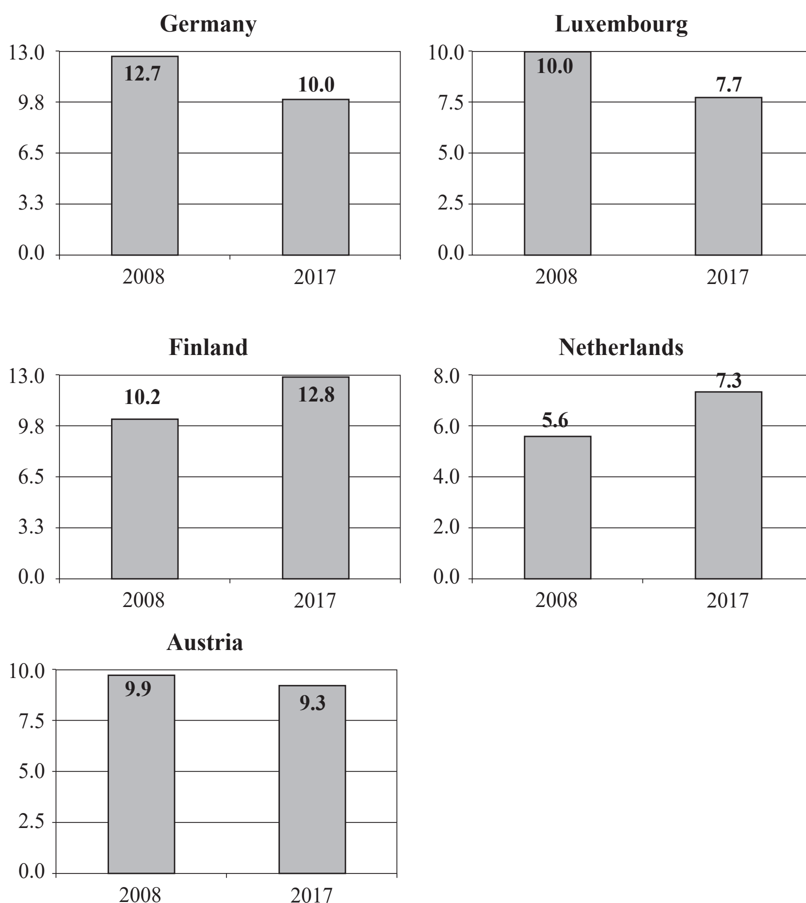
As is well-known, many young people have struggled in the labour market for quite a long time. However, the problem of youth unemployment and inactivity was starkly exacerbated by the global financial crisis. Today's younger generation is at risk of ending up poorer than their parents (Dobbs et al., 2016). This risk includes young people in the affluent European countries which were hit by the financial and banking crisis in the euro area in 2010. Young and less educated workers were hardest hit. According to the OECD (2016), in 2015 the number of young people not in employment, education or training (NEETs) was still higher than before the onset of the crisis in nearly all OECD countries (40.0 million).

The labour market divides people into two major groups: active (which includes both employed and unemployed individuals) and inactive. As emphasised by Krzysztof Szewior (2016), from the social point of view, the problem of the economic and social inactivity of young people and people entering the labour market is of the utmost importance, which is why I decided to concentrate on this particular group.

The number of NEETs is one of the best measures to assess the current predicament and economic conditions of young people (OECD, 2016). Unlike the conventional unemployment rate, it takes into account not only those who are looking for a job and are still on the labour market, but also includes "inactive" individuals – young people who are not in an

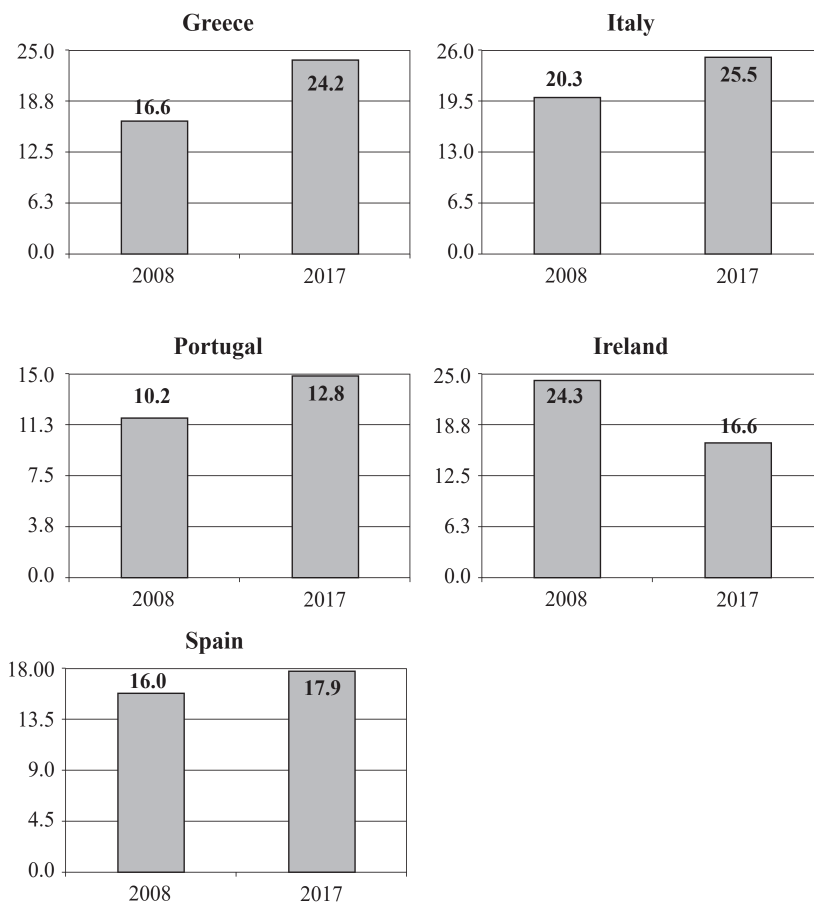
educational and training program, do not work and have stopped looking for a job. Also, the number of NEETs is a particularly well suited indicator to make predictions with regard to the future career paths of young Europeans. Empirical economic analyses show that the inability to find employment in the first few years after college or high school graduation damages the whole future career path. It is almost certain that today's NEETs will earn lower wages than their more successful peers even ten or twenty years from now.

Figure 1. NEETs in the eurozone northern countries



Source: author's own analysis based on Eurostat [edat_lfse_21].

Figure 2. NEETs in the eurozone southern countries



Source: author's own analysis based on Eurostat [edat_lfse_21].

This data presents the striking north/south divergence in the euro area with regard to the young Europeans who struggle to find a job and start a professional career.

In most of the northern "core" countries (three out of five) the number of NEETs fell following the outbreak of the global financial crisis in 2007 and subsequent eurozone crisis. Despite harsh economic conditions in Europe, the majority of northern countries managed to contain the rise of NEETs in the first phase of the crisis and actually reduced their overall

numbers during the subsequent decade. In Germany – which at the beginning of the 21st century was still struggling with the economic consequences of reunification, its overstretched welfare state and record levels of unemployment during the chancellorship of Gerhard Schröder – the number of NEETs fell from 12.7% in 2008 to 10% in 2017.

Similar processes occurred in Luxembourg (a drop from 10% in 2008 to 7.7% in 2017) and – to a lesser extent – in Austria (drop from 9.9% in 2008 to 9.3% in 2017). The number of NEETs modestly increased only in Finland and the Netherlands. In general, the number of NEETs in the northern countries remains at a relatively low level. In 2017, in all but one of northern countries it did not exceed 10%. It reached 12.8% only in Finland.

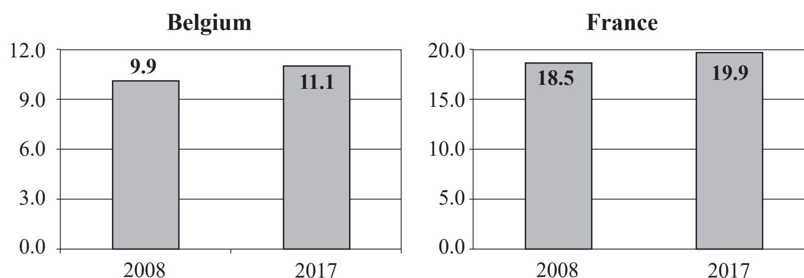
In the south, the opposite is true. In most of the southern "deficit" countries (three out of four), the number of NEETs rose as a result of the crisis; in the case of Greece and Italy, to worryingly high levels. In Greece, the number of NEETs rose from 16% in 2008 to 24.2% in 2017. In Italy, it rose from 20.3% in 2008 to 25.5% in 2017. This means that in both of these countries roughly every fourth young person is either unemployed or inactive. After almost a decade of financial turmoil, there are also now more NEETs in Portugal, although the rise in this case was not so dramatic. Despite this moderate increase, Portugal scored the best among southern countries with the lowest rate of NEETs (12.8%). All other southern countries have larger – usually much larger – numbers.

However, when benchmarked against the eurozone north, even Portugal fares poorly. The Portuguese "best" score among southern countries is equal to the "worst" score in the northern group (also 12.8%, in the case of Finland). One cannot escape the conclusion that the best that the South can hope for is the least satisfactory score among northern countries.

In the group of crisis-ridden countries which suffered the most after 2007, only Ireland has made a visible improvement in terms of the needs of the young. The number of NEETS fell from 24.3% in 2008 to 16.6% in 2017.

Finally, France – a pivotal country for the future of the eurozone – offers a bleak picture. Once the crucial part of Franco-German engine of European integration, recently it has become what Mark Vail (2015) called "Europe's middle child," trying to mediate between austerity champions in the north and debtors in the south. By virtue of its "mixed" economic model and unique traditions of *dirigisme*, France used to differ substantially both from the "export-led growth" economies in the north

Figure 3. NEETs in the eurozone centre



Source: author's own analysis based on Eurostat [edat_lfse_21].

and "demand-led growth" models of the south. However, the eurozone crisis seemed to have moved France decisively from the north to the south of the EMU. France's traditional political clout and international competitiveness declined. Its labour market is in increasing need of reform. Social unrest intensified as the political movement of the "yellow vests" took to the streets in order to protest against the labour market reforms proposed by President Emmanuel Macron.

The data on NEETs presented here supports the claim that France is now part of the eurozone south. The number of NEETs in France rose from 18.5% in 2008 to 19.9% in 2017. As a result, almost every fifth young person is neither in employment nor in education or training. The number of NEETs in France situates this country clearly in the southern group.

The general conclusion that can be drawn from this analysis is the following: in terms of the fortunes of the young people, there is no longer one eurozone but two; the northern one that, despite the harsh economic conditions during the crisis, successfully managed to educate their youth and find them a place on the labour market, and the southern one that suffered the most during the crisis and remains unable to respond to the basic needs of their youngest citizens.

3. Economic security in the EMU and divergent views on the euro

The eurozone crisis was a unique crisis. Although it shared some of the features of previous debt and balance-of-payments crises, it was set within a monetary union that strongly constrained the policy options avail-

able to policy makers (Walter, Frieden, 2017). From the point of view of European integration, it was the first “real” crisis since the origins of the European project.[6]

The asymmetry between the political and economic power of eurozone member states resulted in a situation in which the costs of crisis resolution have been borne almost exclusively by the debtor countries and their taxpayers. As a consequence, the eurozone crisis has significantly altered the traditional continental balance of power. Germany has become more powerful than it has been since the end of the Second World War (Beck, 2014; Kundnani, 2015; Matthijs, 2016a). France is lagging behind both economically and politically (Vail, 2015). The gap between the “surplus” north and “deficit” south is much bigger than before the crisis. Instead of bringing about progress towards “ever closer union” among Europeans, the euro and its crisis in fact revived old animosities, created new dividing lines and ultimately pulled European nations further apart.

Since 2010, northern and southern eurozone member states have had increasingly divergent views on how to solve the eurozone crisis. Germany has repeatedly stressed the importance of austerity measures, i.e. limiting public spending, balancing budgets and reducing excessive debt (Blyth, 2013). The ECB’s “easy money” policies, in the form of liquidity facilities and special programmes such as the Securities Market Programme (SMP) and Outright Monetary Transactions (OMT), met with strong criticism in the northern countries (Fratzscher, 2018; Brunnermeier et al., 2016). Former German Finance Minister Wolfgang Schäuble from the CDU publicly blamed Mario Draghi, the President of the European Central Bank, for the electoral gains of the far-right *Alternative für Deutschland* (AfD). According to Schäuble, low returns on German pensioner’s savings, which resulted from the ECB’s quantitative easing (QE), made older Germans more willing to vote for the populist and anti-European AfD (Wagstyl and Jones, 2016). He added that the ECB’s monetary policy was causing extraordinary problems for Germany and is not reasonable.

[6] The eurozone crisis was the first “real” EU crisis because it required decisive intervention, in the absence of which the single currency and the EU itself would not have survived. In the case of past crises, whether it was the “empty chair crisis” of the 1960s, or the subsequent crises of the European “snake in the tunnel” in the 1970s, or “Euro-sclerosis” in the 1980s, or the collapse of the Soviet Union in the early 1990s, the EEC or the EU could have stood by and done nothing without any major calamity. For more on this argument see: Parsons, Matthijs, 2015.

It is worth mentioning that the AfD originated as a result of a split within the CDU over its policy towards the eurozone crisis and financial support for the southern countries (Siri, 2018). Its initial message was not the opposition to the German *Willkommenskultur* and Merkel's open migration policy, but a demand to put an end to financial transfers to crisis-ridden countries and possibly take Germany out of the eurozone. In the party manifesto for the European elections in 2019, the AfD for the first time mentioned the idea of Dexit – Germany's exit from the EU (*Leitantrag der Bundesprogrammkommission*, 2019).

In 2017, Minister of Finance of the Netherlands and President of the Eurogroup Jeroen Dijsselbloem commented on the predicament of the southern countries and decided to give their citizens the following advice: "You cannot spend all the money on women and drinks and then ask for help" (Khan, McClean, 2017). Dijsselbloem's comment was emblematic of the will of many European politicians, mostly from northern countries, to put all the blame for the eurozone crisis on the "profligate and irresponsible" south, in particular Greece, and, in a way, hellenise the story of the Europe's economic troubles (Krugman, 2012). Debtor countries in the eurozone's periphery were lumped collectively into one general flawed category, in spite of the fact that they have very different crisis etiologies (Fourcade, 2013). In response, Portugal's Minister for Foreign Affairs, Santos Silva, called on Mr Dijsselbloem to resign. Silva said that "it seems that the president of the Eurogroup has spent all these years without understanding what really happened to countries like Portugal, Spain or Ireland" (Khan, McClean, 2017).

Southern countries proposed different policies in order to overcome the crisis. Austerity measures imposed on many of them in response to the crisis hit many unionised workers and other lower income groups, while protecting some powerful lobbies that were the biggest beneficiaries of pre-crisis boom years (Hopkin, 2015). They were in general supportive of the accommodative stance of the ECB and its "easy money" monetary policy, as well as a common euro area fiscal pool and public investments aimed at stimulating demand and reviving economic growth after the recession. What they were not able to do was to build a political coalition in support of these proposals and convince the northern countries to move from the politics of austerity towards a more demand and investment-oriented approach.

Conclusions

The European countries were unprepared to face the North Atlantic global financial crisis and its spillover in the form of a banking and debt crisis in the eurozone. The institutional weaknesses of the EMU, initial negligence and a series of non-decisions on the part of European leaders contributed to transforming what was at first a relatively manageable double-dip recession into a prolonged and systemic crisis that put the whole European project in danger. As this paper has argued, the euro crisis gave rise to the dangerous divide between the core "surplus" countries in the north and peripheral "deficit" countries in the south. A striking divergence with regard to the career prospects and economic conditions of young Europeans emerged as a result of the euro crisis. The northern countries were relatively successful in educating their youth and allowing them entry to the labour market, while the southern economies seemed to be unable to respond to the basic needs of their youngest citizens.

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