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Economic situation in the Economic Commission for Europe region: Europe, North America and the Commonwealth of Independent States in 2011-2012

Summary

Economic growth throughout most of the Economic Commission for Europe (ECE) region has been very slow in the last five years, the Central Asian economies being the exception. Numerous economies currently have real gross domestic products (GDPs) below that achieved prior to the start of the global crisis and the subsequent recession that began in 2008. In those economies that have managed to achieve some growth, it has been extremely slow by historical standards or global comparisons. A few economies have not yet recovered at all from the initial crisis; some had weak and short-lived recoveries but have since relapsed into double-dip recessions, while in the remainder, economic recovery has been weak and their growth in 2013-2014 is forecast to be low and below trend. In addition to this weak GDP growth, much of the region has experienced high unemployment and increasing poverty.

In the ECE region, both the financial crisis in 2008-2009 and the timid recovery in 2010-2012 represent significant policy failures. The crisis was largely the result of insufficient and improper regulation of the financial sector in the advanced economies of North America and Europe and the excessive reliance on external capital for developmental finance in the economies in transition and the European Union new member States. Although the fiscal and monetary stimulus policies enacted in the immediate aftermath of the crisis were a vast improvement over the responses in the 1930s and prevented a world depression, macroeconomic policy in 2010 shifted prematurely to austerity, thereby extending and, in some cases, worsening the economic downturn. What was needed was stimulus in the short run combined with an agenda for consolidating finances in the long run, but the political

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processes in the advanced economies were unable to achieve that outcome. In some cases, the austerity measures implemented to improve the debt situation actually worsened it by significantly reducing economic growth. The eurozone crisis has raised fundamental questions about the desirability and sustainability of designing a monetary union without integrated financial supervision, a fiscal union and a central bank that can act as a lender of last resort.

I. Economic Commission for Europe region in global perspective

1. For analytical purposes, the 56 members of the Economic Commission for Europe (ECE) region, which has a population of over 1.2 billion, are divided into three major subregions: (a) North America, with a population of 344 million, composed of Canada and the United States of America; (b) the European advanced economies, with a population of 522 million, composed of 35 economies including the European Union, the European Free Trade Association, Israel and four European micro-States with fewer than 100,000 people; and (c) the European emerging economies, with a population of 374 million, composed of 19 economies in Eastern and South-Eastern Europe, the Caucasus and Central Asia. The latter includes all the economies in transition as well as Turkey. The term "advanced ECE economies" refers to North America and the European advanced economies.

2. The ECE region remains quite diverse. Although it contains most of the world's advanced economies, 26 (almost one half) of its member States have a per capita income below twice the world average; 13 of these are below the world average and 5 are below one half the world average. Nine of its economies are considered United Nations landlocked developing countries.

3. For over a century, the ECE region accounted for over one half of world economic output (on a purchasing power parity basis), but in 2009, its share fell below 50 per cent owing to the more rapid growth in the developing economies. A decade ago, the European advanced economies and North America each accounted for over a quarter of world output and the European emerging countries accounted for another 5 per cent. The world shares of the European advanced economies and North America have now declined to just over a fifth each, while that of the European emerging countries has increased to 6 per cent. The share of the ECE region in world output is expected to continue to decline by about half a percentage point each year in the coming decade since its growth in population and per capita income is below world averages.

4. In the last three decades, growth in the advanced ECE economies has been relatively slow compared to other world regions and to their own post-World War II historical experience. In the last decade, the growth of per capita income has been relatively similar in the world's advanced economies; more specifically, growth was slightly higher in Japan (.75 per year) than in the United States (.65 per year) and the eurozone (.55 per year). The European emerging economies experienced a major economic collapse in the 1990s and have had moderate recoveries in the last decade, but national income in a third of these economies is still below its 1989 level. In most of the ECE economies, income and wealth inequality have increased substantially; in particular, the income of the very rich has grown significantly above the average. Thus, the economic models of these economies are increasingly experiencing difficulty in producing strong economic growth while maintaining or increasing equity. Nevertheless, the levels of income and equity in many of the Western European economies, especially those in Scandinavia, are among the highest in the world.

5. In 2010, the ECE economies accounted for 54.7 per cent of world exports; 74.7 per cent of their exports (or 40.8 per cent of world exports) went to another ECE economy. In addition, 33.8 per cent of exports from non-ECE countries went to

an ECE economy. Thus, 70 per cent of 2010 world exports had an ECE economy as either the source or destination. Over 81.1 per cent of exports from European advanced economies, 77.1 per cent of exports from European emerging economies and 52.5 per cent of North American exports went to another ECE economy. The economies in transition, which became partially segmented from the rest of the global economy in the decades after the Second World War and since 1990 have encountered problems in obtaining normal tariff treatment owing to slow progress in obtaining accession to the World Trade Organization (WTO), accounted for 4.1 per cent of world exports in 2010.

6. The ECE economies are a major global source of outward foreign direct investment (FDI); in 2010, their FDI outflows increased by 13 per cent, accounting for almost $914 billion in FDI outflows or over 69 per cent of the world's total FDI outflows. Despite the increase in 2010, ECE FDI outflows were still only about one half their level in 2007 before the financial crisis; by comparison, FDI outflows from non-ECE economies increased by almost 6 per cent between 2007 and 2010. Of the world's top 20 sources of FDI, 13 are ECE economies. The United States is the largest source of FDI in the world, followed by Germany and France. In addition, the Russian Federation is a major source of outward FDI.

7. The ECE economies were the destination for over $647 billion in FDI inflows in 2010; this represented over 68 per cent of world FDI inflows. However ECE FDI inflows in 2010 were less than half the value of inflows in 2007; by comparison, non-ECE inflows declined by only 5 per cent between 2007 and 2010. In 2010, FDI inflows to the European emerging economies were down by 43 per cent from their peak in 2008. Of the world's top 20 destinations for FDI, 10 are ECE economies; the United States is the largest recipient of FDI inflows in the world. Overall, the ECE region is a net investor of FDI (namely, outflows exceed inflows) and in 2010, it supplied approximately $266 billion of net FDI to the rest of the world. However, the European emerging economies were a net recipient of FDI (namely, inflows exceed outflows) in 2010 and their inward FDI stock has increased by almost 1,000 per cent since 2000.

II. Long-term evolution of the region

8. In the first two decades after the Second World War, the countries of Western Europe and the Soviet Union grew faster than the United States; thus, there was some convergence in the per capita incomes of these regions. By the early 1970s, Western Europe had a per capita income of approximately 70 per cent of that of the United States, while the Soviet Union had a per capita income of about 35 per cent of that of the United States or one half of that of Western Europe. Since 1972, there has been no further convergence between Western Europe and the United States, while the average income of the states of the former Soviet Union has declined to only a fourth of that of the United States and a third of that of Western Europe. Therefore, in the last 40 years, there has been no convergence, but in fact some additional divergence, in the living standards of the three major geographical subregions of the ECE. Currently, the average per capita income of the economies in transition is approximately equal to the average for the world economy.

9. The difference between United States and Western European per capita incomes is owing in large part, to differences in hours worked. Europeans generally

work fewer years (starting later and retiring earlier), take longer vacations, and work shorter days. The United States advantage in productivity per hour worked is much smaller. However, the convergence in productivity levels that occurred during the 1960-1995 period ceased and has actually reversed since 1995, owing to the more intensive use of information technology in the United States. Comparisons of productivity growth in the foreign operations of United States multinationals versus domestic firms in foreign countries suggest that the United States proclivity for using information technology is the result of different management practices.

10. Western Europe has had a high unemployment problem for three decades. The average unemployment rate in France, Germany, Italy, and the United Kingdom of Great Britain and Northern Ireland averaged 3.5 per cent in the 1970s but more than doubled in the 1980s to 7.6 per cent, 8.9 per cent in the 1990s, and 7.7 per cent in the first decade of the twenty-first century. In the United States, the overall unemployment rate has been more stable in the last four decades; however, in the past 50 years, the unemployment rate for African Americans has generally been above 10 per cent, almost double that of whites.

11. Ageing of the population is a characteristic of most of the ECE economies except those in Central Asia. Ageing, which implies an increase in the ratio of pensioners to workers, has significant implications for achieving sustainable fiscal positions since many countries have “pay-as-you-go” pension systems. In many European economies, the retirement age is low by global norms and will need to be increased, especially in the case of women, who have particularly low retirement ages in many economies. Older workers already account for an increasing proportion of the workforce in many ECE economies; for example, the percentage of United States workers 55 or older has increased from 17.5 per cent in 2006 to 21.5 per cent in 2012. Increasing the pension contribution rate is another option that is likely to be implemented in some of the region’s economies.

12. Ageing has a significant gender dimension in that the ratio of women to men is significantly above 1 for persons aged 65 and older. In the European Union, this ratio averages 1.4, but is over 2 in Estonia and Latvia and almost 2 in Lithuania. Persons 65 years or older have a higher risk of poverty than those of working age (18 to 64), and retired women are significantly more likely than men to be in this category. In Latvia and Cyprus, over half of women 65 and older are at risk of poverty.

III. Economic and financial crisis

13. Initially, the economic crisis had the largest impact on the growth of the transition economies compared to the other ECE subregions and the world economy. This is true both in terms of their absolute decline in output in 2009 (minus 6.5 per cent) and their decline in output from trend levels (a decline of 13 percentage points). However, they experienced moderate recoveries and by 2012, they had the incomes that would have been achieved in 2009 had the crisis not occurred. Thus, these economies “lost” about three years of economic growth. As a result, progress in achieving the Millennium Development Goals has also been pushed back by several years. North America experienced a severe downturn in 2009 but, with a weak recovery, managed to attain in 2012 the income that might have been expected in 2008; the region therefore lost four years of growth owing to the crisis. The

downturn experienced in the European advanced economies in 2009 was greater than in North America but lower than in the transition economies; however, the recovery was very weak and fell back into negative growth at the end of 2011 and beginning of 2012. It is unlikely that these economies will get back to the level of income that they had in 2007 before 2013, thus they will have lost six years of economic growth as a result of the crisis and its aftermath. By comparison, the economies in the rest of the world economy (namely, non-ECE economies) lost only about a year of economic growth owing to the crisis.

14. Failure to implement more aggressive macroeconomic stimulus policies in order to restore growth in Europe in the immediate aftermath of the 2008-2009 crisis resulted in increasing debt-to-GDP ratios, which then precipitated the periphery eurozone sovereign debt crisis of 2010-2012. In response to this second dip crisis, additional austerity programmes resulted in even lower GDP growth, which further worsened fiscal positions. As a result, a number of economies ended up with low to negative growth, high unemployment and excessive deficits and debt. The institutional design of the eurozone has limited the use of macroeconomic countercyclical policy and lowered the macroeconomic performance of the region. There are significant similarities between the economic developments and policy responses in Europe in the last five years and what happened in the first half of the 1930s.

15. Recent experience in the ECE region highlights the importance of discretionary macroeconomic policy as a countercyclical policy tool for addressing economic shocks when economies are severely depressed. Under the conditions that have existed in many of the advanced ECE economies in the last several years, namely, interest rates near zero and high unemployment, fiscal policy is largely self-financing in the medium term. Even in cases where the debt-to-GDP ratio might deteriorate slightly in the medium term, the economic benefits of fiscal expansion in terms of lower unemployment are likely to significantly outweigh the cost of slightly higher debt ratios; in addition, creditworthiness might even improve with growth despite a minor deterioration in debt dynamics. In numerous economies, there appears to have been a preference for using tax cuts as opposed to government spending increases as a mechanism to increase aggregate demand. However, the tax cuts had low multipliers and produced relatively small increases in demand, and thus proved to be of only limited effectiveness.

16. Between 2007 and 2010, total employment in the United States declined by 4.7 per cent or 6.9 million jobs, while in the European Union, it declined 1.2 per cent or 2.6 million and in the Russian Federation by 0.7 per cent or 0.5 million. Although the economies that suffered the largest declines in GDP were generally those that experienced the largest declines in employment, there were major exceptions which suggest that labour market policies can be important in limiting unemployment increases during economic downturns. Given the large decline in GDP in the Russian Federation, the increase in unemployment in that country was particularly low. Although the economic declines in the eurozone and the United States were roughly similar, unemployment increased far more in the latter.

17. Since the financial crisis, there has been a significant increase in debt levels in the advanced ECE economies that will need to be reduced in the coming decade. This process of deleveraging has proceeded most rapidly in the United States compared to most of Europe. In the United States, although public sector debt has

increased significantly since 2008, private sector debt has declined. As at the beginning of 2012, United States household debt had declined by $600 billion owing largely to a decrease in mortgage debt. Americans were able to reduce mortgage debt by defaulting on their non-recourse mortgages. European households, however, generally have been unable to reduce their debt through defaulting since their recourse mortgages discourage this approach. Sovereign debt in North America and the European advanced economies has continued to increase rapidly.

18. Fiscal deficits and sovereign debt have been much more moderate in many of the economies in transition relative to the European advanced economies and North America. The Russian Federation, which had sizable surpluses in the years prior to the crisis, had moderately large deficits in 2009 and 2010, but then was able to reduce them to about only 1 per cent of GDP; these may widen again in the future since the Government plans to sell $50 billion in domestic bonds in each of the next few years. Ukraine has had relatively small deficits except in 2009 and 2010, but State-run enterprises are accumulating contingent liabilities that may prove problematic. Kazakhstan has generally had surpluses.

19. The economic downturn in the last several years did not lower income proportionally throughout the income distribution in most ECE economies. Although the prices of equities, which are largely owned by upper-income individuals, declined significantly, the price of housing, which is owned by the middle class, declined even more, and the increases in unemployment were much greater for low-income groups. Although the increase in government transfers accrued mostly to lower- and middle-income households, low-income households experienced the largest proportional decline in incomes overall. Although inequality declined significantly after the Great Depression in the 1930s, that was mostly owing to explicit policy changes and only marginally to the destruction of wealth.

20. Although the European Union new member States and the European emerging economies experienced a very serious crisis in 2009 with some large declines in GDP, the severity of the crisis was not even close to that of the economic decline experienced in the 1990s during the transition from planned to market economies.

IV. Eurozone crisis

21. After the creation of the euro, the sovereign spreads on 10-year debt of the eurozone economies stayed within 100 basis points until the economic crisis in 2008, since financial markets made little differentiation in their debt. However, since the crisis, and especially after the realization in January 2010 that the Greek debt situation had not been properly reported, markets have increasingly required a premium to hold the bonds of eurozone countries with high or rapidly increasing debt levels. One important reason for this is that there is no lender of last resort to back these sovereign bonds since the European Central Bank is restricted from performing this role. As a result, the eurozone economies have had to design some other institutional structure to perform this function.

22. The European Financial Stability Facility was established with resources of €440 billion from guarantees by eurozone sovereigns with AAA credit rating. It provided about €200 billion in assistance to Greece, Ireland and Portugal. In January 2012, after Standard and Poor’s downgraded France and Austria to AA+, the Facility was also downgraded to AA+. The Facility is due to expire in July 2013 and is

ultimately to be replaced with the permanent €500 billion European Stability Mechanism due to begin in July 2012. Owing to a perceived need for a larger facility, there have been discussions about the degree to which the two funds might coexist during the 2012-2013 period.

23. A total of 25 of the 27 European Union members signed a deficit-reduction treaty in March 2012 that committed them to better control deficits and debt after the Stability and Growth Pact failed to satisfactorily accomplish that objective. The fiscal compact requires structural budget deficits to average less than 0.5 per cent of GDP and total government debt to be under 60 per cent of GDP. The European Court of Justice can impose fines of up to 0.1 per cent of GDP on countries that violate the limits. Although this may contribute to more fiscal discipline, it will also limit their ability to use fiscal policy as a countercyclical policy tool.

24. Greece, Ireland, Italy and Portugal have sovereign debt-to-GDP ratios above 100 per cent and increasing. Government expenditures as a percentage of GDP have not been particularly high in these economies; the problem was that revenues were too low owing to poorly designed tax systems and weak compliance. For that reason, the emphasis needed to be on increasing revenue and not on cutting expenditures; however, that was not the main focus of the austerity programmes that were implemented. Many of the countries (namely, Greece, Spain and the United Kingdom) that implemented an austerity plan were unable to achieve the deficit or debt reductions that were forecast at the time the programmes were initiated. This was because the austerity programmes led to larger than expected declines in growth, which further depressed tax revenues and thus fiscal positions. The experiences of Sweden and Finland, which suffered a financial crisis in the 1990s, support the view that austerity should not be implemented until a recovery is well under way.

25. Throughout 2011, interest rates in major European economies (the United Kingdom and Sweden) with central bank backing for their sovereign (10-year) debt declined. In the eurozone, where there is no central bank lender of last resort, German rates declined; French and Spanish rates experienced some volatility but ended 2011 at a rate similar to that at the beginning of the year; and Italian rates increased significantly. Approximately €794 billion in sovereign debt is likely to be issued in 2012, €220 of it by the eurozone's largest issuer, Italy. The interest rates on some non-eurozone European Union sovereign debt, for example in the case of Hungary, also increased significantly in 2011.

26. In the spring of 2012, under a collective action clause, Greece restructured its sovereign debt, essentially eliminating €105 billion of its €348 billion debt; private sector investors were forced to take a loss of 78.5 per cent. This was the largest debt restructuring agreement in history and the first default by a developed economy in half a century. The International Swaps and Derivatives Association ruled the "voluntary default" a credit event, resulting in the payment of €2.5 billion in credit default swap insurance. The objective of the restructuring was to put Greece on a path to lower its debt from 160 per cent of GDP to 120 per cent by 2020. As a result, Greece received €130 billion in new official loans, which included €28 billion from the International Monetary Fund (IMF), to be distributed over the next four years.

27. Greece was required to implement a strict austerity programme as a condition for financial support from the European Union and IMF. This included reducing the minimum wage by 20 per cent to €560 per month and by 32 per cent for youth under

25, reductions in health-care spending and other social welfare payments, and the elimination of 15,000 public sector jobs by the end of 2012 and 135,000 more by 2015.

28. European financial markets began to tighten considerably in the second half of 2011 as interbank spreads widened and some banks were frozen out of commercial funding markets. For example, United States money market funds significantly reduced lending to eurozone financial institutions. As a result, at the end of 2011, the European Central Bank undertook several actions to reduce European banks' reliance on private markets. They created a longer-term refinancing operation which provided three-year loans worth €489 billion (equivalent to 5 per cent of eurozone GDP) at 1 per cent interest to 523 banks. The European Central Bank also broadened the eligibility criteria for collateral. This was followed in March 2012 with a second liquidity injection of €529.5 billion to 800 banks. These actions averted an impending credit crunch and also resulted in lowering the yields, which had reached unsustainable levels, on Spanish and Italian sovereign debt. In the two months after the first European Central Bank action, the interest rates on Italian 10-year debt declined from 7 to 5 per cent and Spanish yields fell from 6 to 5 per cent. The European Central Bank also lowered interest rates in the second half of 2011 in two separate quarter-point declines back to their previous historical low of 1 per cent.

V. Current economic situation

29. Real GDP growth in the ECE region is expected to decline in 2012 to 1.3 per cent from 2.1 per cent in 2011 and 2.8 per cent in 2010. Growth in the European advanced economies is likely to be close to zero in 2012 as many of them experience recessions; growth in North America should increase slightly in 2012 to 2.1 per cent as recoveries in Canada and the United States gather strength while growth in the European emerging economies declines but still remains moderate at about 3.2 per cent. Growth is forecast to pick up in 2013 in all three subregions and further strengthen in 2014. Despite modest growth, most of the economies in the ECE region will continue to operate below their potential with significant unused labour resources. The economic slack in the region should keep domestically generated inflation in check, although higher commodity prices from a more robust global economy could keep inflation close to the target levels of the region's central banks.

30. There is considerable variation in growth rates within each of the subregions of the ECE. Although Canada and the United States have similar growth rates, the rates in the different states of the United States and provinces of Canada vary significantly. Within the European advanced economies, the two fastest growing economies with growth above 2.5 per cent in 2012 are forecast to be Israel and Poland; both of these economies have performed relatively well in the medium run, since neither has experienced negative growth on an annual basis since 2003. Estonia and Lithuania are forecast to register growth of over 2 per cent in 2012 but this represents a bounce-back from deep recessions in 2009 and neither economy is back to its pre-crisis level of income. Norway may also experience growth over 2 per cent in 2012. All the eurozone periphery economies that have encountered difficulties in marketing their sovereign debt (namely, Greece, Italy, Portugal and Spain) except Ireland are likely to experience declines in GDP in 2012. With a GDP

change of -3.3 per cent in 2009, -3.5 per cent in 2010, -6.8 per cent in 2011 and -6 per cent in 2012, Greece has been the world's worst performing economy. There is considerable variation in the European emerging economies as well, but only Croatia is expected to have negative growth in 2012. With a growth rate of 9.2 per cent in 2010, 11.9 per cent in 2011 and 7.0 per cent in 2012, Turkmenistan has been one of the fastest growing economies in the world in the last several years. The other Central Asian economies will have solid growth in 2012, while growth in the economies in South-Eastern Europe will be modest.

31. Monetary policy in North America and the European advanced economies remains very supportive of growth, with interest rates at or near historic lows. Between 2008 and the end of 2011, the United States Federal Reserve quadrupled its balance sheet, while the European Central Bank doubled its balance sheet through various "quantitative easing" programmes to inject liquidity into the European advanced economies. This raised some concerns about how this might affect inflation, and inflation has been slightly above central bank targets in the advanced ECE economies. Inflation is currently about 2.6 per cent in both the eurozone and Canada, and about 2.9 per cent in the United States. However, core inflation has generally been below the overall rate and domestically generated inflation through wage increases has been low. Inflation has been about 10 per cent in Turkey, 3.5 per cent in the United Kingdom and 1.7 per cent in Israel. Switzerland has been experiencing very slight deflation owing to the exceptional strength of its currency. Inflation has been declining in the Russian Federation and was only about 4 per cent in early 2012, which is considerably below the central bank target; inflation in most of the other countries of the Commonwealth of Independent States (CIS) has been in the 5 to 10 per cent range.

32. Owing to a severe drought and forest fires, Eurasia experienced an extremely poor grain harvest in 2010; as a result, the Russian Federation imposed a year-long wheat export ban. In 2011, agricultural output in the Russian Federation was up by 16.1 per cent and rose significantly in Kazakhstan and Ukraine. Given the importance of food in the calculation of consumer inflation in these economies, inflation declined considerably in 2011, and the 6.1 per cent rate in the Russian Federation was the lowest since the transition to a market economy began in 1991. However, the 2012 grain harvest has been damaged by drought conditions in some areas, especially in Ukraine, and may be less than that produced in 2011.

33. There was considerable variation in the movement in housing prices in the ECE economies in 2011. Prices continued to decline in many countries, including Bulgaria, Greece, Ireland, the Russian Federation, Spain, Ukraine, and the United States, while prices increased slightly in others, including Austria, Canada, Estonia, Germany, Norway, Switzerland and Turkey. Housing prices in many Western European economies appear to be above the level predicted by longer-term relationships between prices and personal income or rents.

34. The median United States sales price of an existing single-family home increased annually for 30 years until 2005, but has declined yearly since then and has now fallen by 34 per cent (or almost 40 per cent in real terms) since its peak in 2006; the current price in real dollars is back to the 1990 level. Currently, about 12 million homeowners, or one in five with a mortgage, owe more on their mortgage than the value of their house; this amounts to $700 billion more debt than their homes are worth. Although foreclosures remain high and may increase further still,

there are some positive developments, including mortgage interest rates at historic lows, inventory levels returning to their normal range, declining unemployment, and housing prices in line with their long-term relationships with rental costs and family income. House construction remains at only about a third of pre-crisis levels.

35. An important challenge for the European emerging economies is increasing their macroeconomic stability. Volatility in these economies has been high and is due to two main factors: their export dependence on a concentrated number of commodities and their financial dependence on external capital. Policies are therefore needed to diversify their production structures into high-tech manufacturing and high value-added services; this includes increased funds for education and training, infrastructure development, and research and development. Entrepreneurship could be increased by improving access to credit. During stressful periods, capital outflows from these economies can be substantial. This is due to previous historical episodes when investors lost wealth from extremely high inflation, lack of deposit insurance during bank failures, and weak enforcement of property rights. The European emerging economies therefore need to further develop their financial sectors so that they can better channel domestic savings into domestic investment. Several of the resource-rich economies have been able to use their sovereign wealth funds to help stabilize their economies.

VI. Employment

36. Between 2005 and 2010, unemployment in the United States doubled to almost 10 per cent, but has declined to slightly above 8 per cent. However, it has remained at that level since February 2009, making it the longest time unemployment has been above 8 per cent since the 1930s; approximately 40 per cent of the unemployed in the United States have been so for six months or longer. Unemployment has been declining in Canada and is down to about 7.5 per cent. Unemployment has yet to peak in the European Union, where it is slightly over 10 per cent, and is approaching 11 per cent in the eurozone; there is significant variation, however, with unemployment in 12 of the 27 European Union economies at 10 per cent or more but 5 per cent or less in two of them. In the European emerging economies, unemployment has been quite high in most of South-Eastern Europe, where it is over 10 per cent and is more structural than cyclical; official unemployment rates in most CIS countries have returned to their pre-crisis levels of below 10 per cent.

37. Youth unemployment is high in both the European advanced economies and the European emerging economies; in 2011, it was about 18 per cent in both. This is relatively high by global standards, with only the Middle East and North Africa experiencing higher rates. In the European advanced economies, unemployment among young men is higher than among young women, while in the European emerging economies the opposite is true. Youth unemployment is about 2.75 times higher than adult unemployment across countries and through the business cycle. Given this relatively constant multiple, the most effective strategy for lowering youth unemployment would be to lower overall unemployment. In the European emerging economies, informal employment, as well as contract employment, without standard benefits is high so many young people with jobs are nevertheless in situations where they do not have social insurance or pension coverage. Limited employment prospects for young people may be a factor behind teenage suicide;

Belarus, Kazakhstan and the Russian Federation have the three highest rates in the world and these rates are approximately three times that of the United States.

38. Labour force participation rates have declined owing to the sluggish economic conditions. Although this is largely the result of discouraged workers leaving the workforce, it is also due to increasing numbers of young people pursuing additional education and an ageing workforce retiring. For example, in 2012, the percentage of young people in college in the United States reached an all-time high.

39. Given the high levels of unemployment, a key area for structural reform being pursued in many of the European advanced economies concerns labour markets. Generally, there is a belief that labour markets are excessively rigid and that reform along the lines of the Scandinavian model of "flexicurity" is needed. This model attempts to provide firms flexibility in using their labour force, including hiring and firing, while providing workers with income security should they be negatively affected by firms' decisions.

40. The unemployment rate throughout the region is generally lower among persons with more education. For example, in early 2012, the United States unemployment rate was 4.2 per cent for college graduates; 7.5 per cent for those with some college education; 9.5 per cent for high school graduates; and 14.8 per cent for persons without a high school diploma. In addition, the latter earn less than half of what college graduates earn.

41. Female participation in the workforce remains particularly low in Southern Europe and many of the European Union new member States. There is no relationship between female labour force participation and motherhood across European countries; thus motherhood is not a critical factor as long as there are appropriate social support systems. In 2010, women accounted for over two thirds of the underemployed (part-time workers who want a full-time job) in the European Union. The decline in employment of state and local government workers in the United States over the last several years was particularly significant for women; declining female employment accounted for 70 per cent of the 765,000 net lost jobs in this sector between 2007 and 2011.

42. High levels of unemployment are more costly for United States workers than for those in the European advanced economies because the country's social safety net is less extensive. For example, 40 per cent of the unemployed in the United States do not qualify for unemployment benefits because they did not work full-time or had not been in their jobs long enough to qualify. Long-term unemployment is associated with a persistent reduction in earnings (20 per cent less) even 20 years later, increased mental and physical health problems, lower life expectancy, and even reduced earnings for their children.

VII. Inequality and poverty

43. Inequality has increased throughout the ECE region in the last two decades. It is especially high in Israel, Italy, Portugal, the Russian Federation, Turkey, the United Kingdom and the United States. The income shares of the top one per cent have grown especially fast. Inequality has increased even in the European economies with strong social welfare models, such as Denmark, Germany and Sweden; France, however, is a notable exception to this trend. Although taxes and

social transfers can reduce the inequality of market-based incomes considerably, over time these redistributions have been scaled back and have become less effective. Inequality increased substantially in most of the economies in transition after their transition to market economies.

44. The increase in inequality in the ECE region is due to globalization, skill-biased technological change, and government policy changes that reduced taxes on the rich and social payments to the poor. For example, marginal taxes on the richest have declined over time. In the United States, the top statutory rate declined from 90 per cent in 1958 to only 35 per cent in 2009, and the current tax rate is lower for every income level (relative to 1958); at the same time, the percentage of those paying a tax rate of 15 per cent or below has increased substantially over the last several decades. In some cases, labour market policies have weakened workers' employment protections and/or unions through regulatory or institutional changes. In the last few decades, union membership or union coverage (compensation determined by union bargaining regardless of individual membership) has declined in many of the advanced ECE economies; the latter remains above 50 per cent in most of Europe but is only 13 per cent in the United States.

45. The increase in inequality is the result of a reduced share of income earned as wages and salaries (corresponding to an increased share to capital owners) and an increase in wage income inequality. In the United States, the labour share of national income declined from an average of about 65 per cent between 1955 and 1985 to less than 58 per cent in 2010. The labour share in the pre-2004 European Union-15 has declined from 71 per cent of national income in 1980 to under 66 per cent.

46. Intergenerational economic mobility has declined in recent decades from the higher levels achieved between 1950 and 1980. In the ECE region, the economies with the highest levels of income inequality have the lowest intergenerational mobility. Contributing to this trend is the increasing importance of human capital in explaining the variation in income and an increasing gap in the academic achievement between children from rich and poor families. For example, in the United States, the top 1 per cent of households receives about 70 per cent of its income from the ownership of capital and much of this is passed from one generation to the next; 82 per cent of children from the richest quarter of households obtain a college degree while only 8 per cent of those from the lowest quarter do so.

47. In almost all the ECE advanced economies, the share of income going to the top 1 per cent has increased substantially in the last several decades. In the United States, the top 1 per cent of households has increased its share of national income from 10 per cent in 1980 to about 25 per cent today; the share of the top 10 per cent of households increased from slightly over 30 per cent to 50 per cent during the same time period. Between 1993 and 2010, over 50 per cent of the increase in real United States income went to the top 1 per cent of households. Even in Denmark, Norway and Sweden, where the top 1 per cent have a far smaller share of national income, their share has increased by almost 75 per cent since 1990.

48. The fact that wages have failed to rise is not owing to a lack of economic growth. For example, in the United States, the real weekly earnings of production and non-supervisory workers (which includes approximately 80 per cent of the non-government workforce) declined by almost 14 per cent between 1972 and 2011 despite the fact that labour productivity almost doubled. Median household earnings

increased during this period, but this is largely due to the fact that more married women entered the labour force. However, between 1999 and 2010, even United States real median household income declined by 7 per cent.

49. In the European emerging economies, approximately 54 million people or about 14 per cent of the population lives in poverty. This varies considerably, with rates of over a quarter of the population in Armenia, Georgia, Turkmenistan and Uzbekistan and approximately a fifth in the Republic of Moldova, the former Yugoslav Republic of Macedonia and Turkey. In the European emerging economies, in order to provide stronger safety nets with enhanced fiscal sustainability, a significantly higher percentage of employed persons need to be incorporated into the formal economy. Currently, the shadow economy represents over 30 per cent of the GDP in South-Eastern Europe, over 40 per cent in CIS countries and over 60 per cent in Georgia.

50. Poverty is not an issue just for the lower-income countries in the region. In the United States, the poverty rate increased from 12.1 per cent in 2000 to 15.1 per cent in 2010 and now includes 46.2 million; the poverty rate for African Americans (27.4 per cent) is almost three times higher than for whites (9.9 per cent). Approximately one half (48 per cent or 146 million) of the United States population was either below the poverty line or considered low-income (below 200 per cent of the poverty line) in 2010; 73 per cent of Hispanics are in these two categories. Between 2001 and 2011, enrolment in the United States “food stamp” programme, which provides subsidized food to needy households, increased from 17.3 million to 46.2 million. Between 2001 and 2010, the percentage of non-elderly Americans without medical insurance increased from 14.1 per cent to 19.5 per cent, while the percentage with employer-sponsored coverage declined from 69.8 per cent to 53.5 per cent. In 1979, approximately 84 per cent of low-wage workers (the bottom quintile by hourly pay) had health insurance, with 43 per cent obtaining it through their employer; by 2010, only 61 per cent had any health insurance, with 26 per cent receiving it through their jobs.

VIII. Achieving the Millennium Development Goals

51. Although significant progress has been made towards achieving the Millennium Development Goals at the global level, in some countries, the economic crisis has set back progress in attaining certain targets. As a result, the developing countries remain especially dependent on official development assistance (ODA) from the advanced economies to get back on track. The ECE economies account for 90 per cent of total Development Assistance Committee net ODA and it is therefore their ability to maintain or increase assistance over the next several years that will be critical. The official development assistance to gross national income (ODA/GNI) target for 2010 of 0.36 per cent committed to at the Summit of the Group of Eight, held at Gleneagles, and at the 2005 World Summit was not achieved owing to a number of reasons including, most likely, the economic crisis. In 2010, ODA as a percentage of the GNI of donors was 0.32 per cent, slightly less than in 1990. Particularly important in this regard was the failure by the European Union to achieve its ODA target of 0.51 per cent of GNI, since it provided only 0.46 per cent; eight European Union countries, however, did meet the target. Despite missing its ambitious target, the European Union still provides a higher percentage of its GNI than non-European Union members (except Norway).

52. Within the ECE region, progress in achieving the Millennium Development Goals in the European emerging economies and the European Union new member States has been mixed. Given the large economic declines associated with the transition from planned to market economies, there were significant declines in many of the Goal indicators during the 1990s. Although more recent progress has been strong, even prior to the crisis in early 2008 not all of the European emerging economies were on track to achieve all of the Millennium Development Goal targets by 2015. With the severe downturn resulting from the 2007-2012 economic crisis, progress has been derailed. Achievement of the Goals is most problematic in the CIS countries and, most likely, in the European Union new member States, with South-Eastern Europe in between. Overall, progress has been weakest for the health and environmental indicators.

53. Many of the targets have not been achieved in the ECE economies primarily because the targets have not been attained for specific disadvantaged groups, including certain ethnic communities and geographical subregions. Thus, progress in achieving these objectives could benefit, in particular, from more focused targeting of these specific vulnerable groups. This is especially true for the Roma in some of the European Union new member States and South-Eastern European economies whose relative plight in terms of employment and education outcomes has deteriorated since the transition to market economies. Integration of this group requires increased public support for housing, education and health and better implementation of anti-discrimination employment policies. Increasing their employment in the formal sector would increase tax revenues and social security contributions and, as a result, increased assistance could be largely self-financing.

54. In 2010, carbon emissions increased by 5.8 per cent in the Russian Federation, 4.1 per cent in the United States and 2.2 per cent in the European Union and Canada; this is below the global increase of 5.9 per cent, which was three times the average between 1990 and 2010. ECE economies with increases in emissions in 2010 above the global rate include Belgium, Finland, Kazakhstan, Lithuania, Luxembourg, the Netherlands, Sweden, Turkey and Turkmenistan; the ECE economies that reduced emissions in 2010 include Azerbaijan, Bulgaria, the Czech Republic, Greece, Romania, Slovakia, Spain and Switzerland. Over the longer term, emissions in North America and the European advanced economies have increased by significantly less than 1 per cent per year since 1990, while those of the European emerging economies have declined; by comparison, world emissions have increased annually at a rate of about 2 per cent. The European Union has agreed to reduce its level of emissions in 2020 by 20 per cent from its level in 1990.

55. The energy intensity of production (kg of oil equivalent per $1 of GDP) has gradually declined in most ECE economies since 1990. In the early 1990s, the energy intensity of the European emerging economies was over twice that of the European advanced economies, but that difference has diminished slightly over time and is currently only 50 per cent higher.

56. The European Union attempted to institute a carbon tax on flights landing or taking off from its territory as a measure to limit carbon emissions and raise revenue. However, many non-European Union countries objected to the scheme and threatened some form of trade retaliation. The experience provides a significant example of potential trade disputes that may arise with national and regional attempts to limit carbon emissions in the absence of a globally agreed framework. In

addition, the price for carbon allowances in the European Union carbon market has collapsed to only about a third of what it was prior to the financial crisis.

IX. Regional integration and trade

57. The Russian Federation was accepted into WTO at the end of 2011 after an 18-year accession process; the Russian Federation had been the largest economy in the world (and only Group of Twenty member) not in WTO. Nine of the European emerging economies have yet to join WTO. Kazakhstan has tentatively set its accession for the end of 2012. The customs union of Belarus, Kazakhstan and the Russian Federation moved closer to an economic union at the beginning of 2012 by further liberalizing the flow of capital. In Bosnia and Herzegovina, customs duties on a significant number of products were reduced by 50 per cent on 1 January 2012 as part of an interim trade agreement with the European Union. Negotiations between the European Union and Ukraine on an association agreement and a deep and comprehensive free trade agreement were concluded in 2011 but have yet to be signed. The United States and the Republic of Korea signed a free trade agreement in 2012.

58. Although, overall, the eurozone’s current account is almost balanced, some economies have large surpluses and some have large deficits. The fact that the eurozone has no efficient mechanism for eliminating these current account imbalances inside the currency union has been a fundamental problem underlying the eurozone sovereign debt crisis. Currently, households in the regions with excess savings are unwilling to lend to the Governments in the regions with a deficit of savings. The United States is forecast to continue to run large current account deficits. The current account surpluses in the energy-rich economies in transition are expected to decline in 2012 and 2013.

59. Several significant gas pipelines have recently been constructed in Eastern Europe and Central Asia, which will increase diversification for both suppliers and consumers. The Nord Stream gas pipeline became operational in late 2011 and began transporting gas directly from the Russian Federation into Germany, thereby avoiding transit through East European economies, which has caused numerous pricing disputes in recent years. It is the longest undersea pipeline in the world. A South Stream pipeline projected to be completed in 2015 will transport gas from the Russian Federation under the Black Sea directly to the southern European Union (there is already a Blue Stream from the Russian Federation to Turkey). The Central Asia-China gas pipeline from Turkmenistan through Uzbekistan and Kazakhstan to China, which was inaugurated in 2009, added a second line in June 2011 and is expected to reach its capacity by mid-2012. Additional pipelines to ship gas from the Caspian region to Europe are under discussion.

60. For a number of the European emerging economies, remittances are a very significant component of GNI. For some of these economies, remittances represent a larger financial inflow than either private capital flows or foreign assistance. Remittance inflows as a percentage of GDP fell in most of the European emerging economies in 2008 and 2009 and, in many cases, have not returned to their pre-crisis levels, although the value of remittances has increased in 2011 and 2012. In 2010, remittance inflows greater than 10 per cent of GDP were officially reported for Albania (10.9 per cent), Bosnia and Herzegovina (12.9 per cent), Kyrgyzstan

(20.8 per cent), the Republic of Moldova (23.2 per cent), Serbia (10.4 per cent) and Tajikistan (31 per cent). Remittances are greater than 5 per cent of GDP in Armenia, Georgia, Montenegro and Uzbekistan. In the CIS countries, 31 million people have emigrated to work in another country. Remittances, especially from the Russian Federation, fell by over 30 per cent (or 39 per cent from trend) during the peak of the crisis and were a major channel through which the crisis spread to its neighbours. The European Union has 32.5 million foreign citizens, who provided €31.2 billion in remittances in 2010; remittance outflows from the European Union declined in 2009 but were back to their 2007 level by 2010.