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Economic situation in the Economic Commission for Europe region (Europe, North America and the Commonwealth of Independent States), 2013-2014

Summary

The economic performance of most of the advanced economies in the Economic Commission for Europe (ECE) region has been mediocre over the past six years as judged by both global and historical standards. Growth was low or non-existent, unemployment was high, inequality, which was already high, increased further, investment in infrastructure and research declined and in some cases social safety nets were allowed to deteriorate. This was not inevitable or preordained but was the consequence of a series of policy decisions. Prior to the financial crisis of 2008/09, the financial sectors in those economies were improperly regulated. During the post-2010 recovery period there was a failure to implement well-known, readily available and effective recovery measures. Much analysis has been undertaken regarding how to improve financial market regulation, and some of the resulting recommendations have been or are being implemented. However, there has been less analysis of why the required recovery measures were often not implemented. Nevertheless, growth is expected to increase slowly in 2014 and rise further in 2015. Inflation remains muted.

Although the ECE emerging economies experienced a severe economic decline in 2009 as a result of the global financial crisis, they rebounded sharply in 2010 and 2011, which was followed by a moderate recovery. Growth moderated in 2013 and is expected to decline further in 2014, picking up in 2015. The political crisis in Ukraine has introduced considerable uncertainty into much of the region, and this, combined with possible economic sanctions, is likely to further depress growth over the next year. The region's longer-term outlook has weakened considerably, with growth over the next 10 years in many of those economies expected to be only about half of what was forecast several years ago. This is due to slower than expected progress in addressing longer-term structural and governance issues.

* E/2014/1/Rev.1, annex II.

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I. Economic Commission for Europe region in global perspective

1. For analytical purposes, the 56 members of the ECE region (which has a population of over 1.25 billion) are divided into three major subregions: (a) North America, with a population of 349 million, composed of Canada and the United States of America; (b) the European advanced economies, with a population of 530 million, composed of 36 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 375 million, composed of 18 economies in Eastern and South-Eastern Europe, the Caucasus and Central Asia. This subregion includes all of the countries with economies in transition plus Turkey. The term "ECE advanced economies" refers jointly 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, 29 (or over half) of its members have a per capita income below double the world average, while 13 are below the world average and 4 of those are below half of the world average. Nine of its economies are considered landlocked developing countries. Currently, the average per capita income of the countries with economies in transition is approximately equal to the average for the world economy.

3. The ECE region accounted for over half of world economic output (on a purchasing power parity basis) for over a century, but in 2009 its share fell below 50 per cent owing to more rapid growth in the developing economies; its current share is 46 per cent. A decade ago, the European advanced economies and North America each accounted for over a quarter of world output, and the European emerging economies accounted for another 5 per cent. The shares of the European advanced economies and North America have declined to a fifth each, while that of the European emerging economies has increased to slightly less than 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, as its growth in population and per capita income are both below world averages.

4. In 2012 (the latest year with comprehensive data) the ECE economies accounted for 53.8 per cent of world export, and 72.0 per cent of their exports (or 38.8 per cent of world exports) went to another ECE economy. In addition, 32.9 per cent of exports from non-ECE countries (or 15.2 per cent of world exports) went to an ECE economy. Thus 69.0 per cent of 2012 world exports had an ECE economy as either the source or the destination. Over 77.4 per cent of European advanced economies' exports, 69.2 per cent of European emerging economies' exports and 50.7 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 have since 1990 encountered problems in obtaining normal tariff treatment owing to slow progress in obtaining accession to the World Trade Organization, accounted for 5.6 per cent of world exports in 2012.

5. The ECE economies are a major global source of outward foreign direct investment (FDI); however, in 2012 their FDI outflows declined by almost 27 per cent to about $831 billion, or almost 60 per cent of the world's total FDI outflows. In 2012, FDI outflows from the ECE region were less than half of their level in 2007 before the global financial crisis; by comparison, FDI outflows from non-ECE

economies increased by almost 33 per cent between 2007 and 2012. Of the world's top 20 sources of FDI, 12 are ECE economies; the United States is the largest source of FDI in the world.

6. The ECE economies were the destination for almost $599 billion in FDI inflows in 2012; this represented a decline of over 31 per cent from 2011 but still accounted for over 44 per cent of world FDI inflows. FDI inflows to the ECE region in 2012 declined by over 56 per cent from what they had been in 2007, a major factor behind which was the decline in inflows into Europe by over two thirds. By comparison, non-ECE inflows increased by 18 per cent over the same period. Of the world's top 20 destinations for FDI, 10 are ECE economies; the United States is the largest recipient of FDI in the world. Overall, the ECE region is a net investor (i.e. outflows exceed inflows) of FDI, and in 2012 it supplied approximately $232 billion of the net supply of FDI to the rest of the world. However, the European emerging economies are a net recipient of FDI (i.e. inflows exceed outflows), and in 2012 it had net inflows of over $39 billion. The Russian Federation, the European emerging economies' largest source and destination for FDI, had inflows that approximately equalled outflows in 2012. The inward stock of FDI in the European emerging economies has increased in value by almost 1,200 per cent since 2000.

7. The global share of research and development carried out in the United States and Europe has been declining. In 2001, the United States performed 37 per cent of global research and development and Europe 26 per cent; by 2013 the share of the United States had declined to 30 per cent and the European share to 22 per cent.

II. Long-run 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 and there was therefore some convergence in the per capita incomes of those regions. By the early 1970s, per capita income in Western Europe was approximately 70 per cent that of the United States, while in the Soviet Union, per capita income was about 35 per cent that of the United States, or half that of Western Europe. Since 1972, however, there has been no further convergence between Western Europe and the United States, while the average income of the Countries 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, over the past 40 years there has been no convergence; rather, there has been some additional divergence in the living standards of the three major geographical subregions of ECE.

9. The period of transition from a planned to a market economy was especially difficult for the States of the former Soviet Union and the former Yugoslavia. Per capita income declined by 45 per cent between 1989 and 1998 in the States of the former Soviet Union and by 45 per cent between 1989 and 1993 in the States of the former Yugoslavia. Income surpassed the 1989 level only in 2006 for the former Yugoslav States and in 2007 for the former Soviet States. Between 1990 and 2010, however, six of those States (Armenia, Azerbaijan, Belarus, Estonia, Montenegro and Slovenia) grew faster than the world average. The Maddison Project has estimated income levels in those States prior to their creation (i.e. pre-1989), which allows analysis of their longer-run growth performance. Between 1973 and 2010, five States (Azerbaijan, Belarus, Estonia, Montenegro and Slovenia) grew faster

than the world average. Several of those States (Kyrgyzstan, the Republic of Moldova, Tajikistan, Turkmenistan and Ukraine) had lower per capita incomes in 2010 than they had in 1973.

10. The real per capita incomes (on a purchasing power parity basis) of South-Eastern Europe and the Commonwealth of Independent States (CIS) were similar in 1999 and equalled 72 per cent of the world average per capita income. In 2014, per capita income had increased in South-Eastern Europe to 81 per cent and in CIS to 107 per cent of world per capita income. Over the same period, the per capita income of North America relative to the world level declined from slightly over 5 times the world average to just over 4 times, while that of the European Union has declined by a factor of 3 to 2.5.

11. The growth rate of United States output per capita has been on a downward path for the past half century, and that trend is expected to continue for the next 50 years. Per capita output has declined from an average of 2.0 per cent a year over the past century to 1.3 per cent over the past 25 years to only 0.7 per cent over the past decade. United States real per capita income grew at an average rate of 2.1 per cent in the 40 years prior to the financial crisis, but the current forecast is that it will grow at only 1.6 per cent during the period from 2023 to 2088. A similar pattern is likely for the Western European economies, as their long-term growth rates have been quite similar to those of the United States; over the period from 1870 to 2010, United States per capita income increased at an annual rate of 1.9 per cent, while the rate in Germany and France increased at 1.7 per cent.

III. Economic and financial crisis

12. The collapse of the financial industry in the ECE advanced economies in 2008 created a major global recession both there and in much of the world. Policymaking in the early part of the crisis was significantly better than when a similar financial collapse occurred in the 1930s, as central banks acted more aggressively to lower interest rates and fiscal expansions helped to counter the decline in private sector spending. As the recovery began to strengthen in 2010, however, the monetary authorities became overly concerned about inflation and the fiscal authorities about debt. As a result, the recovery stalled in many of the advanced economies. A similar pattern had developed in the 1930s, and considerable historical research had highlighted this policy failure; yet when faced with a similar set of circumstances in 2010-2013, policymakers essentially implemented many similar counterproductive policies.

13. Most of the ECE advanced economies remain significantly affected by the global financial crisis in numerous respects six years after it began, namely: (a) in half of those economies national income is below pre-crisis levels; (b) unemployment rates remain elevated; (c) debt levels have increased considerably, doubling in many cases; (d) income levels of every economy are below those forecast prior to 2008, and their projected growth rates over the next decade are also lower owing to reduced investment over the past six years; (e) inequality has increased: and (f) in Europe, financial markets remain fragmented, and there remain issues about the solvency of some European banks.

14. Seventeen ECE economies have current national incomes below pre-crisis levels. The country most severely affected is Greece, which currently has an income

over 20 per cent lower it had than prior to the crisis. Over half of the eurozone members and over half of the European Union new member States (i.e. those acceding after 2003) have lower current incomes than before the crisis. The only European emerging economy with income below the pre-crisis level is Ukraine. Half of the European emerging economies have grown reasonably well over the period and have income over 20 per cent greater than the pre-crisis level; the only ECE advanced economy that has grown at this rate is Israel.

15. Six years after the start of the recession, industrial production in the eurozone is 12 per cent below its pre-recession peak; this represents a larger decline than Europe experienced during the depression of the 1930s.

16. At the root of the global crisis was a housing bust in the United States, which began late in 2005 and ultimately resulted in a nationwide price decline of about 32 per cent. Housing starts declined by 79 per cent, from an annual rate of 2.3 million in January 2006 to less than 500,000 in January 2008. Between 2007 and 2010, the rate of household formation declined to only one third of the level prior to the crisis, or 500,000. Although housing starts have recovered slightly over the past several years, they have stabilized at about half the 2006 level. Despite significant increases in house prices in the United States in 2013, prices are still about 10 per cent below their pre-crisis peak, and 11 million homes are “underwater” (i.e. more is owed than the home is worth), with about 3.5 million in foreclosure proceedings. United States home ownership declined from 70 per cent prior to the housing bust to 65 per cent in 2013 and is being forecast to continue to fall to as low as 60 per cent in the coming years.

17. United States federal Government debt held by the public as a percentage of gross domestic product (GDP) (73 per cent) is higher than at any time in history, except for a few years after the Second World War; it has doubled since the beginning of the recession in 2007-2009. Although this ratio is likely to decline slightly over the next few years, it is projected to increase significantly after that and may reach 100 per cent of GDP by 2038, which would match the highest historical level, reached in the 1940s. Gross debt is approximately 95 per cent of GDP in the European Union; over half of the European Union economies exceed the Union’s gross debt to GDP target of 60 per cent. The debt to GDP ratios for most of the European emerging economies are considerably lower and are quite low for the major energy exporters, including the Russian Federation.

18. The evidence increasingly suggests that the economic potential of an economy is influenced significantly by its recent macroeconomic performance. Because of the slow recovery from the recession, investments have not been made, human capital has depreciated or left the labour market entirely and technological innovations have not been made; as a result, the region’s economic potential has been reduced considerably. For example, the potential output of the economy of the United States is estimated by the Federal Reserve to be 7 per cent below what it would likely have been without the latest recession. If economies had grown between 2008 and 2014 at the same rate as they did between 2001 and 2007, the income of the European emerging economies would be 40 per cent larger, the European advanced economies 15 per cent larger and North America 8 per cent larger. Thus, even though the actual growth rate of the European emerging economies has been larger than that of the European advanced economies or North America since 2008, in terms of the reduction compared to pre-crisis trends, the losses in the European emerging

economies have been greater. Uzbekistan is the only ECE economy with faster growth during the post-crisis than during the pre-crisis period.

19. During economic downturns, increases in social spending can help maintain national income as well as provide a safety net for those negatively affected. During the recession and recovery, social spending as a percentage of national income did increase in most of the ECE advanced economies; however, the increases in social spending were the smallest in those economies most affected by the crisis. In several economies, including Greece and Hungary, social spending actually declined.

20. The stimulus programmes that were enacted during the crisis and the recovery period after 2010 in the ECE advanced economies were successful in supporting GDP, increasing employment and reducing poverty. The fact that the recovery was weak to moderate was largely the result of a failure to implement larger stimulus programmes. In some cases, the justification for limiting stimulus was a desire to limit the growth of government debt, but in most cases the stimulus programmes produced enough growth that they were largely self-financed; this will increasingly be the case when a longer-term perspective is considered, as the austerity measures reduced public investment, which will affect longer-run growth. There is an extremely high correlation between the improvement in the structural government balance and the growth rate over the 2009-2013 period. Generally, the debt levels increased the most in those economies that implemented the strictest austerity programmes.

21. Austerity programmes in both the United States and the European Union over the past several years reduced funding for public infrastructure and scientific research, which will have a negative impact on the longer-term growth prospects in those subregions. Public funding for research and development in the United States has fallen by 10.0 per cent in real terms since 2010 and is forecast to fall an additional 8.4 per cent by 2017. In the United States, non-defence public investment has declined from about 2.6 of GDP prior to the crisis to less than 2.3 per cent; this could decline further to only 1.8 per cent by 2020, according to projected budget proposals. This development has reduced short-term growth and employment by reducing aggregate demand and will likely affect medium- to long-term growth. Against this general trend, France has proposed a new 10-year, €3.7 billion industrial policy that will encourage investment in 34 selected sectors supported by enhanced coordination, public contracts and supportive regulations.

22. A major lesson from the financial crisis is that the financial credit cycle, if not mitigated by robust countercyclical monetary policy, will create a boom-bust cycle that will have significant and detrimental impacts. Relying solely on inflation rates to steer monetary policy an ineffective way to create economic stability. A number of policy reforms have been implemented in the ECE region that steer their monetary authorities towards more emphasis on systemic macro-prudential risks.

23. One concept that emerged from the financial crisis was that banks should be subject to countercyclical capital buffers as a way to mitigate the boom-bust financial cycle. Switzerland has implemented such a policy in an effort to cool its real estate market because of escalating property values. In February 2013 the Swiss national bank increased (to 1 per cent) the capital that banks must hold for their risk-weighted property assets; in January 2014 it announced a second increase, to 2 per cent.

IV. Eurozone crisis

24. Policies implemented over the past two years have restored stability to the eurozone although unemployment and debt levels remain high and the banking system remains vulnerable. The eurozone crisis of 2010-2013 was the result primarily of several design defects, the most important of which was that there were no institutional mechanisms to adjust for cyclical changes in aggregate demand and there was no lender of last resort for sovereign debt. The Stability and Growth Pact severely constrained fiscal policy (as does the new "fiscal compact"), and the mandate of the European Central Bank specifically restricted it from considering growth and employment in carrying out monetary policy. As a result, when the region was hit by a major financial shock in 2008-2009, the region did not have in place sufficient mechanisms to correct for the decline in private-sector spending. The nature of the crises that developed in the specific eurozone economies varied significantly from country to country. The underlying cause was banking sector excesses in Cyprus, Ireland and Spain as opposed to excessive government debt in Greece and Portugal.

25. The eurozone has been unable to implement the fiscal expansion that could have restored growth to the region because of the mandates of the Stability and Growth Pact and its excessive deficit procedure. Although some fiscal rules may be necessary to limit profligacy, especially during economic booms, those in place in the eurozone significantly deepened the crisis from 2010 to 2014. The rules created a vicious downward spiral where economic downturns resulted in deficits as tax revenues fell and social spending increased, and the deficits required additional consolidation, which then led to further economic decline. This dynamic was supposed to be moderated to some degree by defining the deficits as structural instead of actual deficits. However, European Union procedures for calculating structural deficits appear to have significantly overestimated their size, thereby leading to excessive austerity. Those procedures were adjusted in the third quarter of 2013 so that they would more accurately estimate the structural deficit; as a result, the degree of austerity required was relaxed. This measure, combined with extensions for several economies to meet their budget deadlines, allowed the economic downturn to bottom out.

26. Because of consolidations, the eurozone deficit declined from 4.2 per cent of GDP in 2011 to 3.7 per cent in 2012 and to 3.1 per cent in 2013. Despite this progress, consolidation will continue for the next several years because of stricter requirements to limit deficits under the 2013 "fiscal compact". The austerity programmes caused GDP to decline further and generally did not halt increases in the debt-to-GDP ratios. For example, the level of Greek sovereign debt increased from 115 per of GDP when the austerity programmes began to 176 per cent in early 2014. Many of the European Union economies experienced a downgrade in their credit ratings because of their rising debt levels, including several that lost triple-A ratings.

27. Five eurozone economies have required some form of European Union-backed bailout over the last several years, namely, Cyprus, Greece, Ireland, Portugal and Spain (for its banks). GDP remains below the pre-crisis level in many eurozone economies, including all of those that required bailouts. Borrowing costs, however, have declined considerably over the past year. Ireland and Spain have completed their bailout programmes and returned to market financing. Nevertheless, Ireland's

debt-to-GDP ratio of 124 per cent remains quite high by international and historic standards. In early 2014, the yield on Spanish five-year government bonds fell to the lowest in the history of Spain and was lower than for similar United States bonds. Greece may need a new bailout programme once the current one is completed; the value of assets that could be sold by the Greek Government in its second bailout, in 2012, was extensively overestimated and was cut by more than half in a reappraisal in 2013. Despite these difficulties, Greece was able to return to capital markets in the second quarter of 2014 with a limited sale of sovereign bonds.

28. The current depression in Greece is similar in severity to the depression in the United States during the 1930s in several respects, including the decline in per capita income by both degree and length and the level of unemployment and the length in which it was above long-term trends.

29. The euro crisis led to a significant "dis-integration" (or redomestication) of European capital markets. The share of foreign sovereign and corporate bonds held by domestic banks fell by half (from over 40 per cent in 2006 to only 21.5 per cent in mid-2012) and was back to the level existing prior to the introduction of the euro in 1999. Credit for small and medium-sized enterprises has been particularly affected.

30. The eurozone banking system remains vulnerable to instability, although there have been some significant regulatory changes. Capital standards have been raised and investors will have to absorb more of the cost of future bank failures. Thus, the potential for banking failures to severely damage government finances, as was the case in Ireland, has been reduced. The European Central Bank has been given supervisory authority over eurozone banks. Additional reforms concerning a common resolution authority and a common rescue fund have yet to be finalized. One proposed reform, to create a common deposit insurance guarantee, remains under discussion.

31. One of the underlying factors behind the eurozone crisis has been the lack of competitiveness of the peripheral economies. In order to correct this, their wages and prices must increase by less than in the healthier eurozone economies. Over the past several years, there has been some adjustment in this regard in Greece, Ireland, Portugal and Spain, but the process is incomplete, and more will be required in the coming years. Although prices and wages have fallen in Greece relative to other eurozone economies, this has yet to create a significant increase in exports. A similar adjustment process has not occurred to any significant degree in Italy.

V. Current economic situation

32. Real GDP in the ECE region is expected to increase in 2014 by 2.2 per cent, which is approximately equal to the average rate of growth in the region over the past 15 years; this is up from 1.3 per cent in 2013. Growth in the European advanced economies is likely to be 1.6 per cent in 2014, as many of them begin to recover from the recession; the eurozone recovery began in mid-2013 after the longest recession in its history. Growth in the European emerging economies is forecast to be 1.9 per cent in 2014, which is slower than in 2013 because of an expected decline in growth in several of its largest economies, including the Russian Federation, Turkey and Ukraine. The strongest growth in the ECE region is expected in North America, where GDP is forecast to increase by 2.7 per cent in 2014 as the

recovery strengthens. Only three ECE economies (Croatia, Cyprus and Ukraine) are expected to have negative growth in 2014. Growth is forecast to pick up in 2015 in all three subregions, and be almost 3 per cent in the European emerging economies and North America, while staying below 2 per cent in the European advanced economies as the eurozone continues to struggle. Despite modest growth in North America and the European emerging economies, there will continue to be significant unused labour resources in those economies in 2014 and 2015. Given the anaemic growth predicted for the European advanced economies, unemployment will continue to remain quite high, declining only slightly.

33. Inflation remains subdued in most of the region, with inflation rates in Canada, the United States and the eurozone below their central banks' targets of 2 per cent. Inflation has been considerably above the 2 per cent target in the United Kingdom of Great Britain and Northern Ireland because of falling productivity and cost-push pressure from a depreciating currency; however, it is forecast to be close to 2 per cent in 2014. Inflation remains low in South-Eastern Europe, although it has been higher and subject to wide fluctuations in Serbia. In the CIS economies, inflation has averaged between 5 and 10 per cent, which is generally low by historical standards; an exception has been Belarus, which has experienced rapid inflation over the past several years, although it has been trending downward.

34. In 2011-2012, inflation in the eurozone was above the target of 2 per cent. It fell below the target for the first three quarters of 2013 and since then has been below 1 per cent. Inflation at this low level has made the economic recovery in the eurozone and the process of adjustment of the peripheral economies more difficult, since it implies deflation in the deficit economies. Deflation has developed in some economies, including Spain. Although this price adjustment mechanism is working, the restoration of equilibrium in the eurozone is a long way off.

35. The region's main monetary authorities have significantly increased their balance sheets since the financial crisis began in 2008. Central bank assets as a percentage of GDP have quadrupled in the United States and United Kingdom, from 6 to 24 per cent, and doubled in the eurozone, from 15 per cent to slightly over 30 per cent, before falling back to about 24 per cent by the end of 2013. The United States Federal Reserve implemented three series of quantitative easing during the period; the latest round began in September 2012, when it began to purchase $45 billion worth of treasury bills and $40 billion worth of mortgage bonds a month. The Federal Reserve announced in December 2013 that it would cut back on those purchases by $10 billion a month beginning in January 2014, with the expectation of ceasing them before the end of the year. Prior to the crisis, almost all of the Federal Reserve's assets were United States treasury bills, but now mortgage-backed securities comprise over a third.

36. Expectations that the advanced economies would scale back their quantitative easing programmes and ultimately their balance sheets led to large capital outflows from many emerging markets beginning in 2013. This led to currency depreciations for some of the European emerging economies and significant declines in international reserves for others. The situation was particularly problematic for those economies in which much of the debt was short term and denominated in foreign currency. From May to July of 2013, Turkey sold 12.7 per cent and Ukraine almost 10.0 per cent of their international reserve assets in an attempt to stabilize their currencies. Turkey increased interest rates significantly in January 2014. Belarus received a loan of $3 billion from the Eurasian Economic Union and

another loan of $2 billion from the Russian Government. The Kazakh tenge, which is pegged to a basket of currencies, was devalued by 19 per cent in February 2014. Capital outflows from the Russian Federation have been a persistent problem, limiting investment and growth in the country; such outflows accelerated in March 2014 after Crimea voted to join the Russian Federation. The Russian Federation spent over $11 billion in March 2014 to limit the depreciation of the rouble. Concerns remain that further monetary tightening in 2014 could intensify capital outflows from emerging economies, including those in Europe.

37. The political crisis in Ukraine in early 2014 resulted in considerable economic instability given that the country was already facing difficult financial conditions. Because of capital outflows and declining foreign exchange reserves, Ukraine imposed capital controls in February 2014. Access by Ukraine to international capital markets became impaired and the cost of credit default swaps insurance against a default on Ukrainian Government debt increased to almost twice that of Greek debt. Ukrainian debt is currently about $73.1 billion, and $12.0 billion is due in 2014. The Russian Government, in early 2014 pledged to purchase $15 billion worth of Ukrainian bonds and agreed to a $5 billion gas price discount. Those commitments were withdrawn, however, after the political crisis developed. In April, Ukraine negotiated a two-year $14 billion to $18 billion International Monetary Fund loan and obtained additional pledges for significant bilateral assistance from the European Union, the United States and Japan. This will be conditional on Ukraine's halving its budget deficit by 2016 from the current level of about 5 per cent of GDP, including the elimination of subsidies for natural gas.

VI. Employment

38. Unemployment reached a historic high of 12.1 per cent in the eurozone in early 2013 and stabilized at 11.9 per cent in late 2013 and early 2014; the unemployment rate has reached depression levels in several eurozone economies. Unemployment in the non-eurozone economies of the European Union has been considerably below that in the eurozone, standing at 8.2 per cent in early 2014. Although the European Union has generous unemployment and social assistance programmes, the fact that unemployment has been relatively high since 2009 suggests that many workers have by now exhausted their benefits and depleted their precautionary savings. Unemployment in Iceland, Norway and Switzerland has been quite low. In South-Eastern Europe, unemployment remains extremely high, at double-digit rates throughout the region and above 20 per cent in most of them; unemployment in Turkey is slightly below 10 per cent. In the United States, unemployment doubled between 2005 and 2010, reaching almost 10 per cent; but by the end of 2013 had declined below 7 per cent. Unemployment since 2010 has declined significantly in many of the CIS economies, reaching a historic low in the Russian Federation, which had essentially achieved full employment before the rate of unemployment began to increase in early 2013.

39. In the decade prior to the financial crisis, unemployment in the European Union and in the eurozone were essentially identical, but since 2011 the rate in the eurozone has increased to a level about 1 per cent higher. In the decade prior to the financial crisis, unemployment in the United States was about 4 per cent lower than in the eurozone; it reached 10 per cent in both areas in mid-2009 at the peak of the crisis, but since then the unemployment rate has declined steadily in the United

States and risen in the eurozone. Currently, the unemployment rate in the United States is over 5 percentage points lower than in the eurozone.

40. The United States civilian labour force participation rate increased consistently from 60 per cent in 1971 to slightly over 67 per cent in 2000. Since then it has declined, to 63 per cent in early 2014. The decline affected both men and women and was concentrated in young and less educated workers. The labour force participation rate for men aged 25 to 54 has declined from almost 97 per cent in the early 1960s to 88 per cent. Total employment declined by almost 8.6 million between early 2008 and the end of 2009; since then it has increased by over 8.2 million but remains slightly below the pre-crisis peak. Thus, although employment has been increasing over the past three years, a significant factor explaining the fall in unemployment in the United States over this period has been the decline in the labour force participation rate. Uncertainty about whether this is temporary, owing to discouraged workers who are likely to return to the labour force once unemployment falls, or is a permanent long-term structural change due to the ageing of the workforce, has made the conduct of macroeconomic policy more difficult.

41. The labour force participation rate in the eurozone over the past five years has been more stable than in the United States; although the participation rate of men declined, that of women, and especially those over 45, increased significantly, keeping the rate relatively constant. The different patterns of labour force participation between the eurozone and the United States explains to a significant degree the much higher unemployment rate in the eurozone. Similarly, the share of the population working in the United Kingdom is near its all-time high, although the number of those in full-time positions (as opposed to part-time and self-employed workers) is still below the level at the beginning of 2008.

42. In the United States, the labour force participation rate of African Americans, which fell to 60.2 per cent, is the lowest since December 1977, while the participation rate for black men has fallen to the lowest level since record-keeping began. A particular problem in creating employment for United States workers, and African Americans in particular, is the difficulty in finding employment for those with a criminal record, who account for almost 7 per cent of the workforce; a much higher rate than in other countries.

43. In the European Union, while significant elements of macroeconomic policy, especially monetary policy, are decided jointly, the wide disparity in unemployment rates among countries has made it more difficult to address unemployment. For example, while unemployment in Greece and Spain is over 25 per cent, it is only about 5 per cent in Austria and Germany, a difference by a factor of 5. In the United States, the unemployment rate is over three times higher in some states than in others.

44. Youth unemployment is generally about twice the level of the overall unemployment rate, and that pattern has remained relatively stable throughout the crisis and during the slow recovery in Europe. In early 2014 the youth unemployment rate was 23.5 per cent in the eurozone and 21.9 per cent in other areas of the European Union. The youth unemployment rate in the European Union outside the eurozone is noteworthy in that it is significantly greater than double the overall rate. The youth unemployment rate (having peaked at over 60 per cent) is

over 50 per cent in Greece and Spain and over 40 per cent in Croatia, Cyprus and Italy.

45. In January 2014, the United States reduced the duration of unemployment benefits to 26 weeks from the 73 weeks that had been temporarily implemented after the recession. Nevertheless, 3.8 million Americans have been unemployed for over six months, approximately three times the level prior to the crisis.

46. The informal economy remains quite large in many of the European emerging economies; empirical estimates find that it accounts for over a quarter of GDP in Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan and Tajikistan. The workers in the informal sector generally are not covered by various forms of social protection, including pension benefits.

47. The United Kingdom was quite negatively affected by the crisis and has endured a slow economic recovery; nevertheless, unemployment has remained relatively moderate, standing at only 7.4 per cent in early 2014; this is due in large part to its flexible labour markets. Instead of unemployment rising, wages fell; real wages in early 2013 were 9 per cent below those in 2007. This was brought about by the fact that throughout the 2009-2014 period, wages increased at less than half the rate of inflation, which briefly exceeded 5 per cent. Employment also benefited from a real trade-weighted depreciation of the exchange rate of 25 per cent between 2007 and 2013.

VII. Inequality and poverty

48. Inequality has been increasing throughout the ECE region for the past two decades; it began increasing in the United States in the mid-1970s and in most of Europe in the mid-1980s. Currently, it is especially high in Israel, Italy, Portugal, the Russian Federation, Turkey, the United Kingdom and the United States. The shares of the top 1 per cent of the population have grown especially fast in North America and the United Kingdom. Inequality has been increasing even in the European economies, with strong social welfare models such as Denmark, Germany and Sweden; the rise in inequality in France has been more moderate. Inequality increased substantially in most of the countries with economies in transition after their transition to market economies and is now slightly higher than in the ECE advanced economies. Despite these recent trends, inequality in the ECE economies is still less than in any of the major regions of the world.

49. The increase in inequality in the ECE economies is due to globalization, skill-biased technological change and government policy changes. Although progressive taxes and social transfers can reduce the inequality of market-based incomes considerably, over time these redistributions have been scaled back as marginal taxes on the richest have declined. One factor that has worked to keep tax rates low for high-income workers is the possibility that they could migrate to other economies that have lower tax rates. Some economies have implemented preferential low tax rates for foreign workers as an inducement for them to move to the country. Countries with preferential tax rates for highly skilled foreign workers include Belgium, Denmark, Finland, the Netherlands, Portugal, Spain, Sweden and Switzerland. These have been found to be quite effective in attracting foreign workers. Thus, in regions with high labour mobility, as in the European Union, international tax harmonization may be a prerequisite for having high tax rates on

high-income individuals as a means of limiting inequality. An alternative is the approach of the United States, which taxes its citizens regardless of where they work.

50. Another factor responsible for increasing inequality has been a decline in labour's share of national income; in the United States it has declined to its lowest level since 1965, while the share going to corporate profits is the highest since the 1920s.

51. In some cases, recent changes in labour market policies have weakened workers' employment protections and/or unions through regulatory or institutional changes. Union membership or coverage (i.e. compensation determined by union bargaining regardless of individual membership) has declined over recent decades in many of the ECE advanced economies, although coverage remains above 50 per cent in most of Europe. In the United States, union membership has declined from about 35.0 per cent in the 1950s to 20.1 per cent in 1983 and to 11.3 per cent in 2012. Unionization has been especially important in improving the incomes of some marginalized groups. In the United States, for example, this has been true for African Americans. Unionized black workers earn 16 per cent more than non-union black workers and are 50 per cent more likely to have health insurance and twice as likely to have an employer-sponsored retirement plan.

52. Incomes, after taxes and transfers, are more unequal in the United States than in Canada and Europe; however pre-tax and transfer incomes are more unequal in the United Kingdom and Germany than in the United States, and taxes in the United States are more progressive than in most of Europe. It is the limited size of transfer programmes in the United States that makes its post-tax and transfer income so unequal.

53. The recession and the lacklustre recovery have further worsened the distribution of income in the ECE advanced economies. In the United States, between 2009 and 2012, the income of the top 1 per cent grew by 31.4 per cent, while the bottom 99 per cent grew by 0.4 per cent; thus the top 1 per cent obtained 95 per cent of the income gains. More generally, fiscal consolidations have negative distributional consequences owing in large part to the higher unemployment they create. Empirical studies of fiscal austerity programmes have generally concluded that spending cuts have more adverse distributional consequences than tax increases.

54. In terms of income, inequality in the United States is now similar to the levels reached in the 1920s. The top 10 per cent receive about half of all income, which is a greater percentage than at any time since 1917, when data were first recorded, and the top 1 per cent receive about a quarter. In terms of wealth, inequality is marginally lower than in the 1920s, but the top 10 per cent still own over two thirds of all wealth, while the top 1 per cent own about a third. Income and wealth are more equally distributed in Europe, but this varies considerably by country; generally, within Europe, inequality is highest in the United Kingdom and lowest in the Nordic economies.

55. Across countries, the degree of intergenerational economic mobility (i.e. the degree to which poor children grow up to be rich adults) is negatively related to level of income inequality. Intergenerational mobility is lower in the United States than in most developed countries and has not changed significantly over time. Within the United States, metropolitan areas with greater intergenerational mobility

tend to have less segregation, less income inequality, better schools, greater social capital and more stable families. Thus, if there were a policy objective to increase intergenerational mobility, these would be the key factors that should be targeted for improvement.

56. Intergenerational mobility in the United States declined between 1950 and 1990 and has remained relatively constant since then. The reason intergenerational mobility has been stable since 1990 despite the large increase in inequality experienced over that period is that that increased inequality is primarily the result of increased income for the top 1 per cent, and this has little impact on measures of mobility for the other 99 per cent.

57. One challenge facing most of the region is that of an ageing population. A widely accepted policy response to this has been to propose to raise the retirement age. However, the increase in life expectancy has been largely the result of higher-income people living longer. Raising the retirement age overall requires unskilled and poorer people, who often have physically difficult jobs, to work longer in order to support wealthier people's longer retirement. For example, for men in the United States who live to at least 65, the life expectancy of the richest half has increased by 6 years over the past 30 years, while that of the poorest half has increased by less than 1.5 years.

58. Although increases in education are often proposed as a way to reduce inequality, even many of the educated who are not in highly skilled jobs have not fared well recently. For example, the median income of a male college graduate older than 25 in the United States declined by 10 per cent between 2007 and 2012. More generally, in both North America and Europe there has been a decline in the number of and wages for middle-skilled jobs. Job growth has occurred for low- and high-skilled workers, while wages have increased only for highly skilled workers.

59. Even in the region's wealthiest economies, food security is problematic. For example, 4 million Canadians, including 1.2 million children, live in households that experience food insecurity. In 2013, 48 million Americans received assistance in the form of food stamps, almost double the 26 million in 2007.

60. Minimum wage is an effective policy instrument for raising the incomes of the unskilled, however many economies in the region do not have a minimum wage and in others it has declined in real terms because it has not been adjusted periodically for inflation. For example, the real minimum wage in the United States has declined by 23 per cent since 1968; if it had been adjusted for both inflation and productivity over the period, it would be over three times higher. Thus relative to real national income, the United States minimum wage is less than a third of what it was in 1968. About a fifth of the European Union economies have a minimum wage higher than the United States.

61. The United States has the second highest rate of relative poverty (defined as income below half the national median) among the advanced economies. The poverty rate increased from 12 per cent in 2002 to 16 per cent in 2012; in addition, 44 per cent of those in poverty have incomes below 50 per cent of the poverty line. Poverty and inequality in the United States are highly related to race; the median income for whites is almost 50 per cent greater than for blacks, median wealth is over 10 times greater and the rate of completion of college is almost twice as high.

VIII. Millennium Development Goals and the post-2015 development agenda

62. Governments, academics, civil society, the private sector and international organizations in the ECE region have been actively engaged in the discussions about the post-2015 development agenda. The United Nations agencies in the region, working through the regional coordination mechanism, produced a report on the region's perspectives for the post-2015 agenda. A regional consultation meeting held in Istanbul in late 2013 was widely attended; the presentations and discussions at that meeting generally reflected a set of objectives for the post-2015 agenda similar to those in the regional coordination mechanism report. The regional coordination mechanism report and documents related to the Istanbul meetings are available from www.worldwewant2015.org/EuropeCentralAsia.

63. Given that the ECE region is composed of countries at almost every level of development, the issues of concern to the region reflect global challenges in creating inclusive, sustainable and prosperous societies. The region therefore has much to contribute in crafting a development framework that is universal in scope and applicable to countries at every income level. Also, since the region is composed of many small countries, it has a wealth of experience in designing frameworks for addressing transboundary issues or issues that can be effectively addressed only at the regional level.

64. Progress has been weak in addressing many of the health-related Millennium Development Goals in the European emerging economies including reducing child mortality (Goal 4), improving maternal health (Goal 5) and combating HIV/AIDS and other diseases (Goal 6). Other health-related issues not covered by the Millennium Development Goals remain important for the European emerging economies. For example, a quarter of Russian men die before they reach the age of 55 — triple the rate in most Western European economies. A large percentage of those early deaths are related to alcohol. Prior to 2006, when additional restrictions were imposed on alcohol consumption, the death rate was even higher, with over a third of men dying before 55. The Russian Federation is one of the 50 countries with the lowest life expectancy for men (64 years) globally.

IX. Regional integration and trade

65. Croatia became the twenty-eighth member of the European Union on 1 July 2013; Latvia became the eighteenth member of the eurozone on 1 January 2014. On that date, nationals from Bulgaria and Romania (the European Union's two poorest economies) obtained the right to migrate and work in any European Union country. Previously the European Union and Switzerland had liberalized labour migration, but in early 2014 Switzerland voted to implement some restrictions on labour flows from the European Union. Generally, citizens from the CIS economies need a visa to enter the Schengen area; however, the European Union has relaxed or is in the process of eliminating visa requirements for Armenia and the Republic of Moldova.

66. Armenia announced its intention of being the fourth country to join the Eurasian Economic Community customs union and has published a timetable for the implementation of 262 measures as part of the process. Currently, 25 per cent of Armenia's imports and 23 per cent of its exports are with other members of the

customs union, primarily the Russian Federation. Armenia's tariffs are currently only about half of the customs union rates and will therefore need to be increased. The Russian Federation is the largest foreign source of investment in Armenia. Kyrgyzstan and Tajikistan are also potential candidates for the customs union.

67. Six CIS countries (Armenia, Belarus, Kazakhstan, the Republic of Moldova, the Russian Federation and Ukraine) implemented a free trade agreement in 2013 covering more than 10,000 groups of goods. The Russian Federation will maintain its export duties on natural gas, wood, and raw materials for heavy industry. Trade disputes are to be settled within the World Trade Organization platform.

68. Research suggests that the long-run economic impact of a country, for example, Croatia, joining the European Union is to increase its GDP by 12 per cent. However, after joining the European Union, Croatia's exporters lost some of their preferential access to other Balkan markets, and their tourism was negatively affected by the need for vacationers from the Russian Federation and Turkey to obtain visas. Croatia is scheduled to receive about €11 billion in European Union structural funds over the next 10 years.

69. The United States has been negotiating two major free trade agreements. The Transatlantic Trade and Investment Partnership had its first round of negotiations in July 2013, while the Trans-Pacific Partnership is in the later stages of negotiations.

70. Over the 1990-2010 period, approximately 6 per cent of total aid-for-trade flows have gone to Europe and Central Asia.

71. The United States and the European Union have agreed on a common framework for regulating the $700 trillion over-the-counter derivatives market, although full implementation is more than two years away.

X. Data developments

72. The United States significantly revised its methodology for calculating GDP beginning in July 2013, which will also be applied to historical data as far back as 1929. The overall effect of the changes was to increase GDP in 2013 by about 3 per cent. The major change was in the way in which intangible assets, such as research and development and the creation of entertainment, literary and artistic works, were incorporated into GDP accounts. The French national statistical institute revised its methodology for calculating the unemployment rate in early 2014 and as a result the rate declined by almost one percentage point.