

Still the Right Agenda for Europe?

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Outline: Europe's growth problem

- Since the start of the crisis in 2007

- A slightly longer perspective: Since the start of the euro in 1999

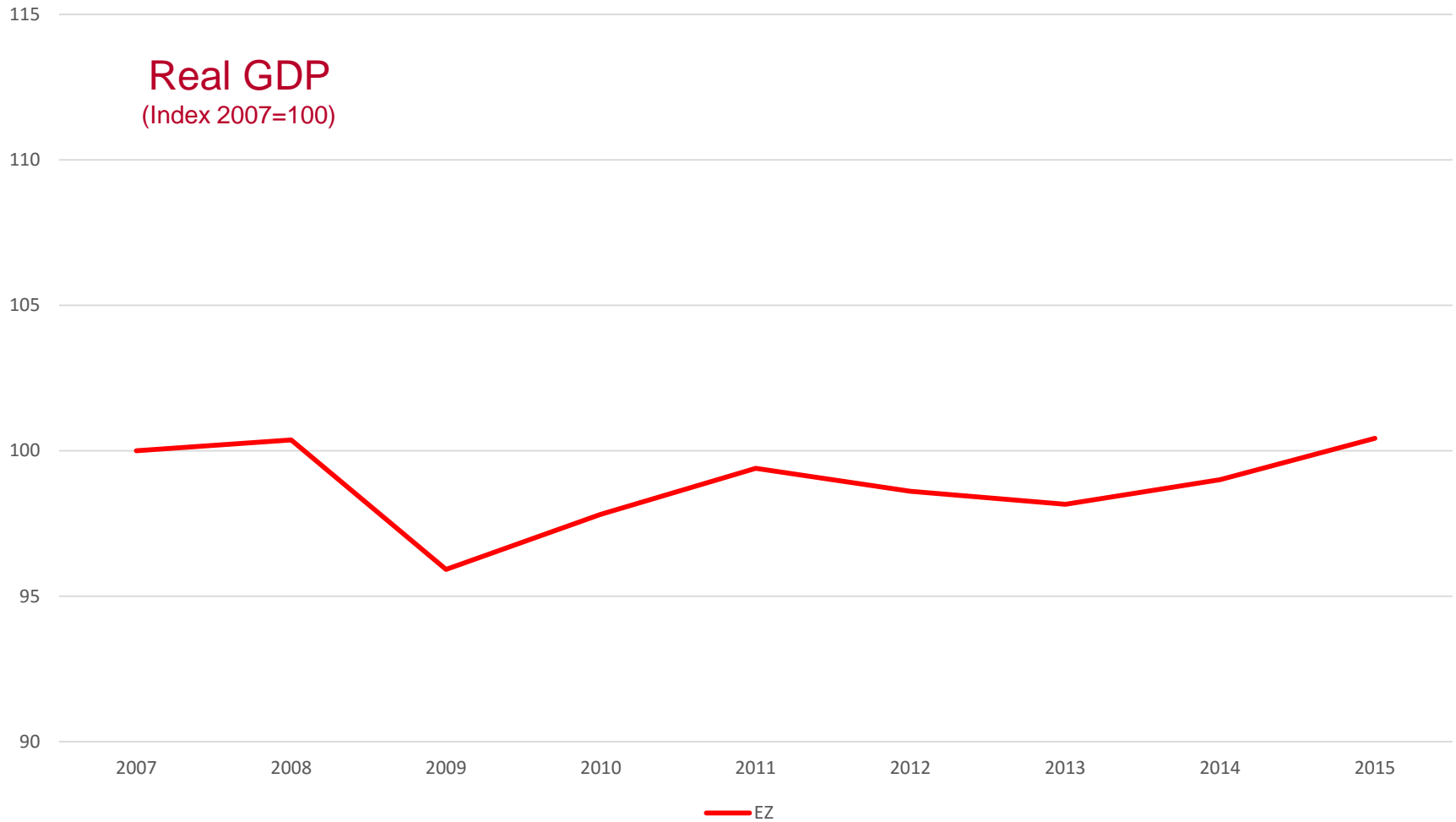
- An even longer perspective: Since the 1970s – An Agenda for a Growing Europe: The Sapir Report (2003, 2004)
 - » Main findings
 - » Main recommendations

- Still the right agenda for Europe?

The EU/Eurozone growth puzzle

- European Commission, October 2014:
“The EU economy is struggling to shake off its lethargy. Since the crisis struck, most Member States have been unable to generate or sustain strong economic momentum.” The result has been “slow growth in the EU and quasi-stagnation in the [Eurozone]”
- European Commission, May 2015:
“The near-term outlook for the EU economy has clearly improved...But will the economy be able to generate a self-sustained and balanced expansion once temporary tailwinds fade?”
- European Commission, May 2016:
“The European economy continues to expand modestly...The economic risks to the baseline of slow but steady growth are mostly to the downside.”

Stagnation in the Eurozone since 2007

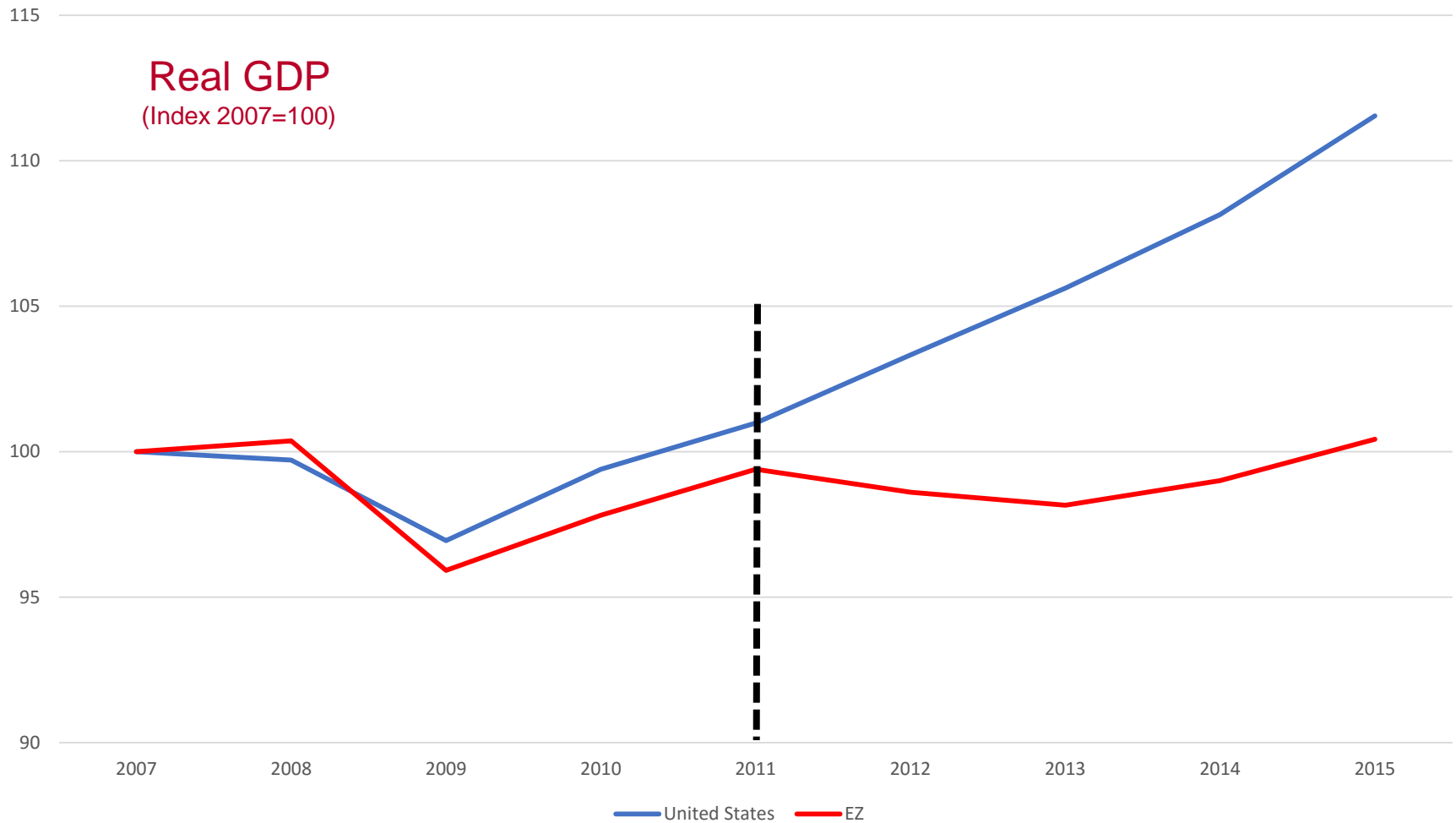


Data source: IMF WEO

The Eurozone growth puzzle: Two opposite views

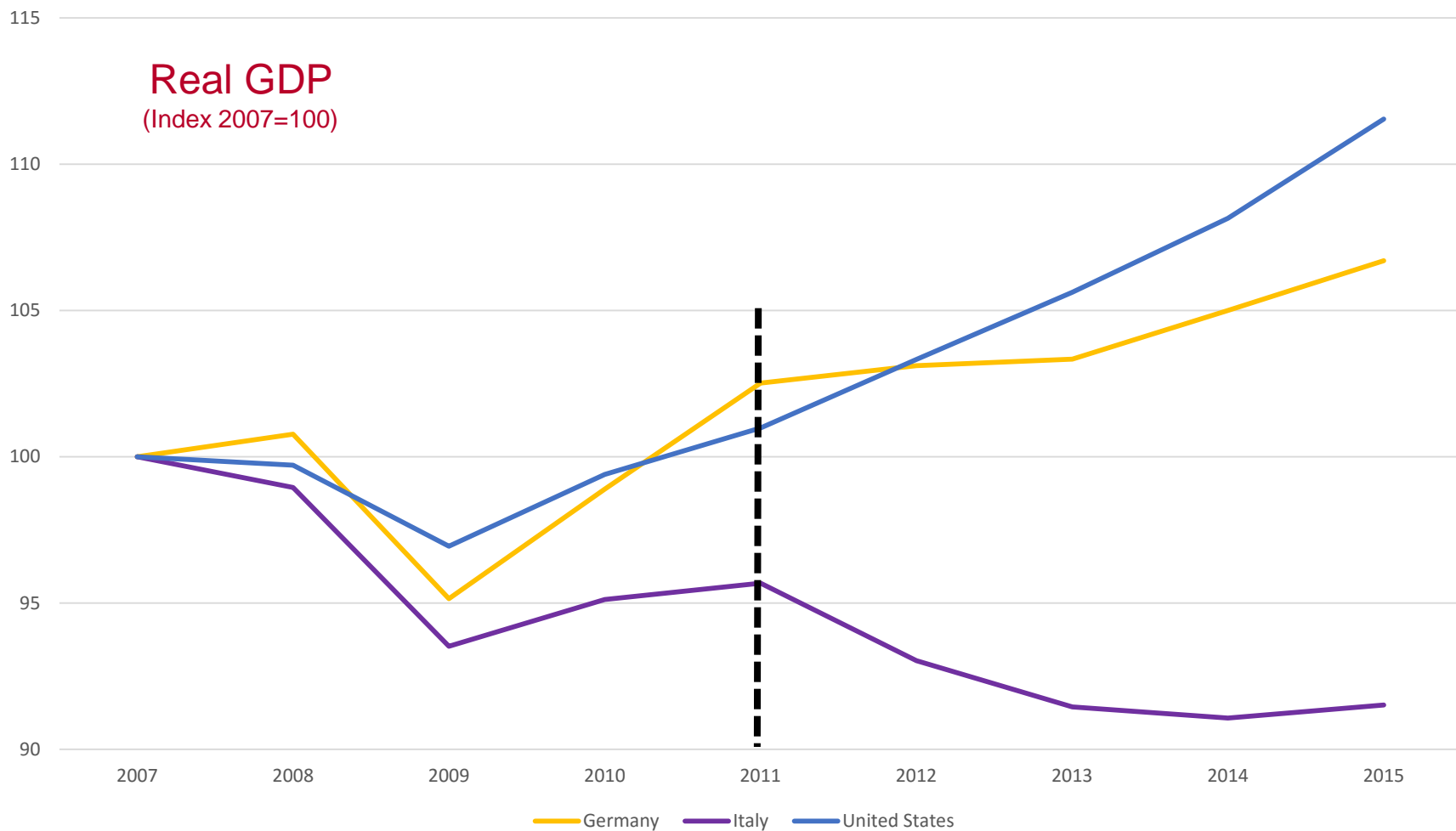
- “In Brussels, Frankfurt and Berlin it is popular to say that this low growth performance of the Eurozone is due to **structural rigidities**. In other words, the low growth of the Eurozone is a **supply side problem**. Make the supply more flexible (e.g. lower minimum wages, less unemployment benefits, easier firing of workers) and growth will accelerate.” (De Grauwe, 2014)
- “**There is a better explanation** for the Eurozone growth puzzle. This is that **demand management** in the Eurozone has been dramatically wrong since the start of the sovereign debt crisis. The latter led the Eurozone policymakers to impose severe austerity on the peripheral Eurozone countries and budgetary restrictions on all the others.” (De Grauwe, 2014)

The demand management view



Data source: IMF WEO

The structural rigidities view

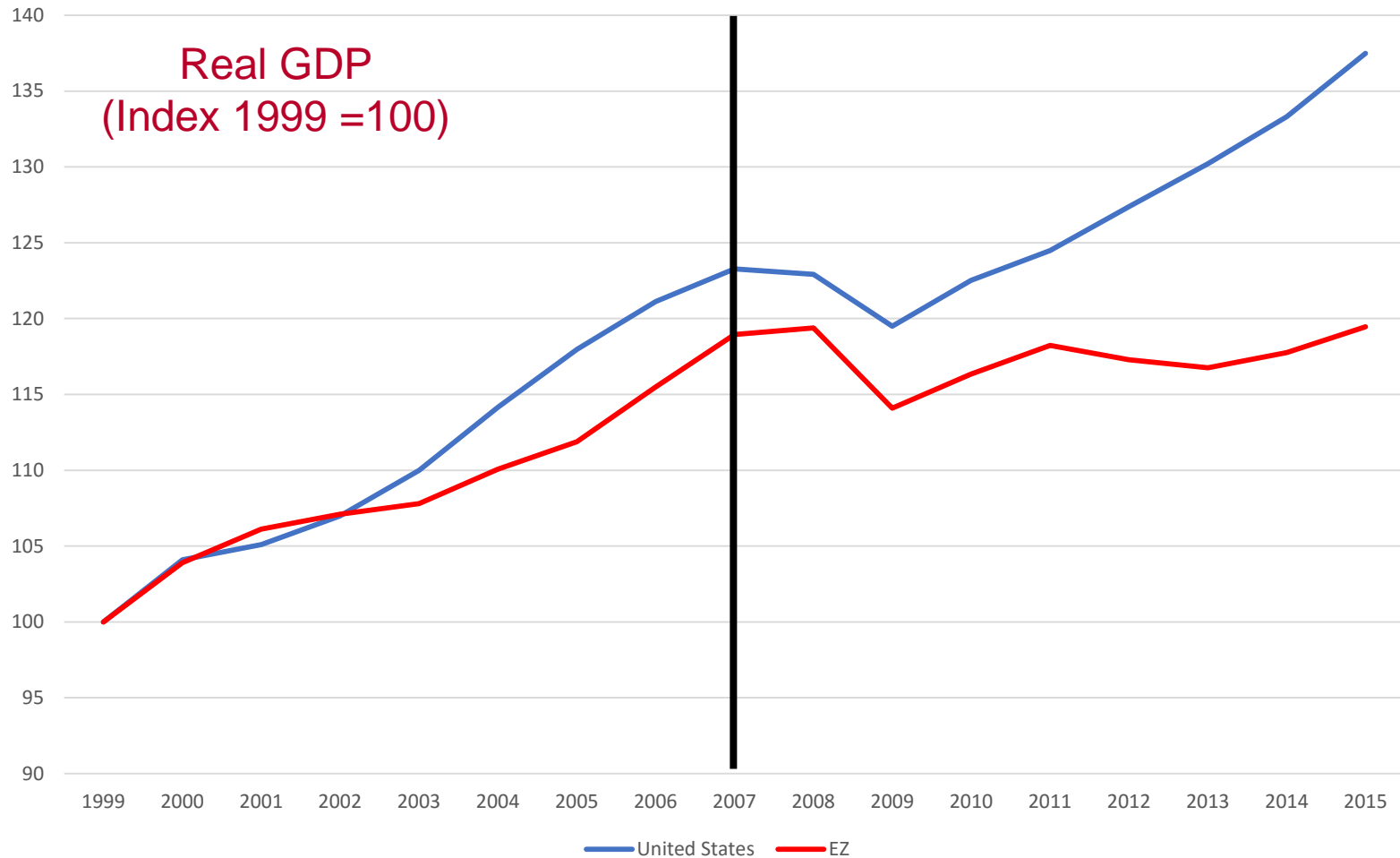


Data source: IMF WEO

A slightly longer term perspective: 1999-2015

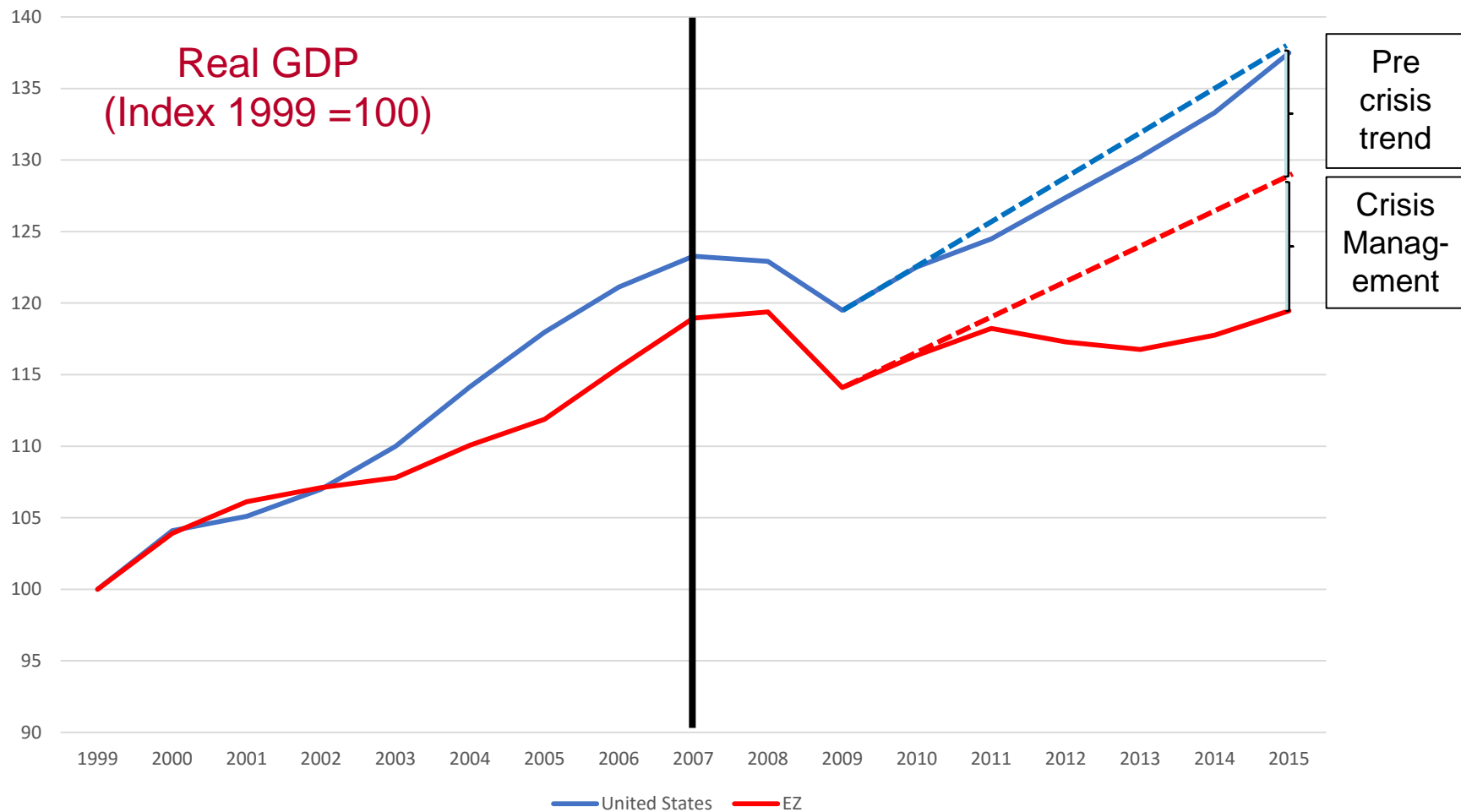
- The EU/Eurozone and the US already had a **different evolution prior to the crisis**
- But the pre-crisis trend difference is not sufficient to explain the **EU/Eurozone stagnation since the crisis**
- This suggests that there are both **structural** and **crisis (rather than simply demand) management** factors which explain the puzzle

The growth situation 1999-2015: Eurozone vs. US



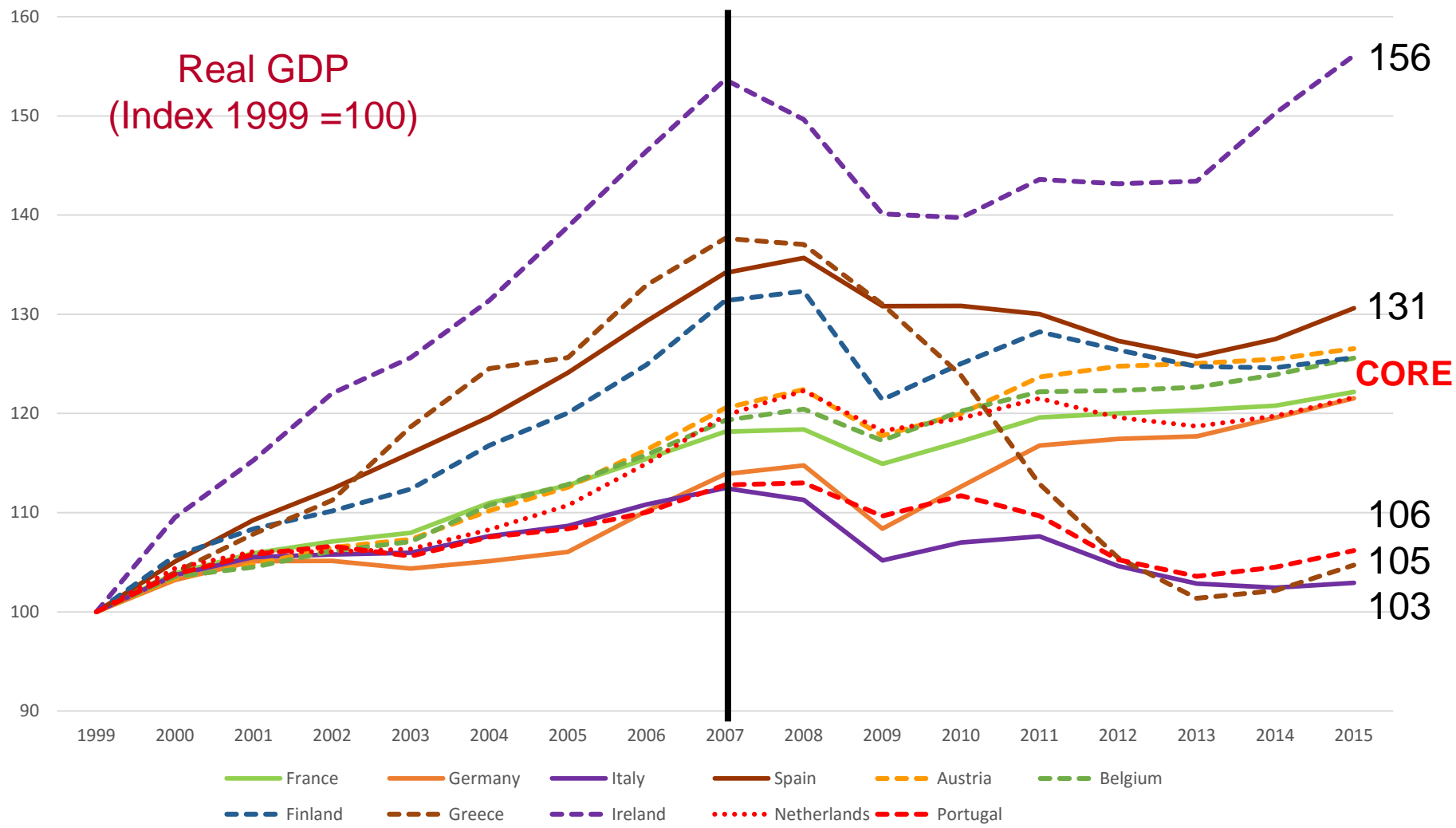
Data source: IMF WEO

The growth situation 1999-2015: Eurozone vs. US



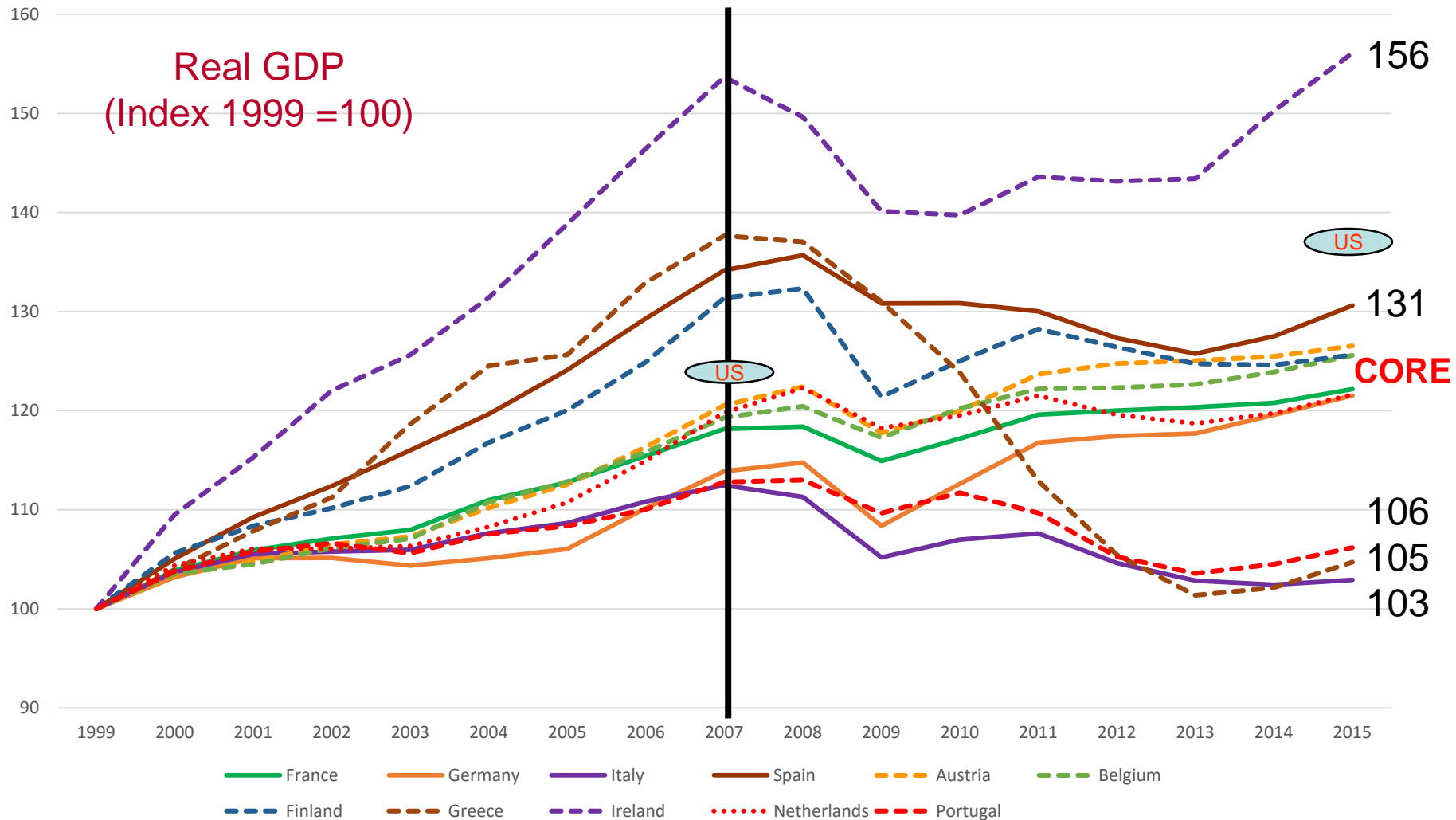
Data source: IMF WEO

The growth situation 1999-2015 : Eurozone Core vs. GIIPS



Data source: IMF WEO

The growth situation 1999-2015 : Eurozone Core vs. GIIPS



Data source: IMF WEO

The Eurozone growth puzzle: A two-handed view

- Eurozone members suffer from **structural rigidities** that require **supply-side reforms**
- The Eurozone **economic management** framework is deficient and requires **governance reforms** in two areas
 - » Management of financial and sovereign debt crises
 - » Demand management

=> EZ states must set both **own house** and **common house** in order

- **Mario Draghi's** Jackson Hole speech **gave the right message**

Eurozone governance: What was wrong with EMU 1.0?

- Impact of EMU on financial integration underestimated & consequences for financial stability ignored:
EMU 1.0 liable to financial crises
- Nature of EMU sovereign debt ignored:
EMU 1.0 liable to sovereign debt crises
- Loss of the ER instrument not compensated:
EMU 1.0 liable to adjustment problems

How should EMU avoid or manage financial crises?

- EMU 2.0 provides a partial answer: SSM and SRM

- EMU 3.0 needs to
 - » Improve SRM, create a common deposit insurance guarantee scheme
 - » Eventually merge SSM, SRM and DIGM into one institution
 - » Reduce bank dependence: Capital Markets Union

How should EMU avoid or manage sovereign debt crises?

- EMU 2.0 provides a partial answer: ESM

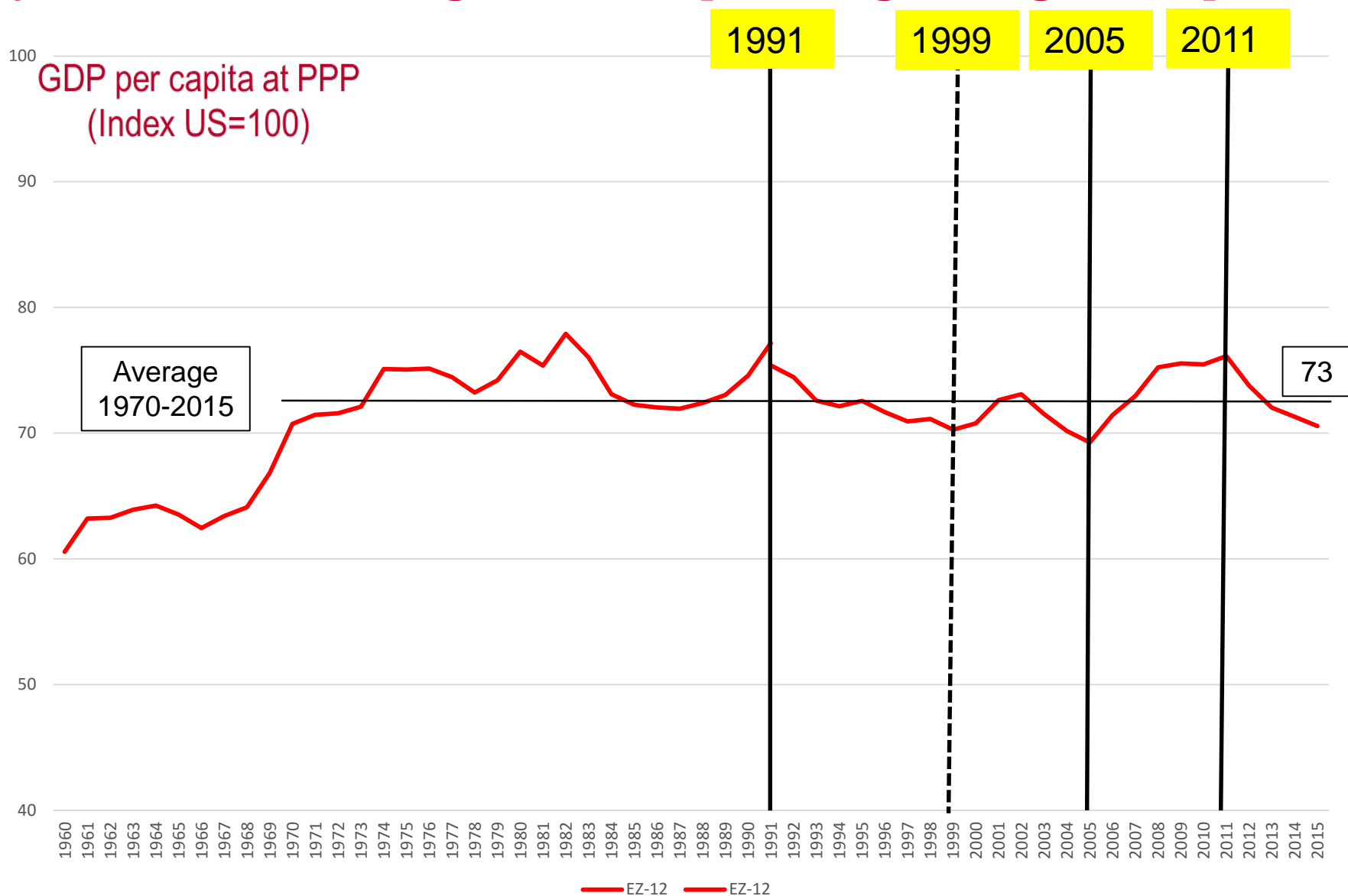
- EMU 3.0 needs to
 - » Better fiscal rules to reduce debt levels
 - » Envisage Eurobonds/Eurobills
 - » Replace ESM by EMF and include a European SDRM
 - » Limit the exposure of banks to sovereign debt

How should EMU avoid or manage adjustment problems?

- EMU 2.0 provides little answer

- EMU 3.0 needs to
 - » Improve market mechanisms at national and EU levels: more **symmetry**
 - » Improve fiscal mechanisms at national and EU/EA levels: more **symmetry**

Beyond the ST: dealing with Europe's long term growth problem



Data source: AMECO

The SR's findings from a decade ago seem still valid today

- “The EU system has failed to deliver a satisfactory **growth performance**.”

“Europe’s unsatisfactory growth performance during the last decades is a symptom of its failure to transform into an **innovation-based economy**.”

“The **context** in which economic policies have been developed **changed fundamentally** over the past thirty years.”

The new context is characterized by **rapid technological change and globalization** and “requires a massive and urgent change in economic policies in Europe.”

The growth decline from the 1970s to 1990s, and beyond

	<i>GDP</i>		<i>Employment</i>		<i>Productivity</i>	
<i>Period</i>	EU-15	USA	EU-15	USA	EU-15	USA
<i>1971-1980</i>	3.0	3.2	0.3	2.1	2.7	1.1
<i>1981-1990</i>	2.5	3.2	0.7	1.7	1.8	1.5
<i>1991-2000</i>	2.2	3.3	0.6	1.6	1.6	1.7
<i>2001-2008</i>	2.0	2.5	1.0	0.9	1.0	1.6

Growth: It Should Have been Europe's Top Priority

- We viewed growth as the sine qua non condition for
 - » the sustainability of the social models
 - » the success of enlargement

- Otherwise, risk for process of European integration

- Increasing growth required **massive reforms**
 - » of economic policies at European AND national levels
 - » of European economic governance


Recommendations for the European level: 6-point agenda

- 1. Make the Single Market more dynamic
- 2. Boost investment in knowledge: Higher & better spending
- 3. Improve the EZ macro policy framework: More symmetry
- 4. Redesign policies for convergence & restructuring
- 5. Achieve effective economic governance
- 6. Refocus the EU budget

The EU budget for growth, cohesion and agriculture (as % of total expenditures for domestic economic policies)

Agreed budget vs. Sapir Report proposal

<i>Budget item</i>	<i>2007–2013</i>	
	<i>Agreed budget</i>	<i>Sapir Report proposal</i>
Growth	11	45
Cohesion	41	40
Agriculture	48	15
Total	100	100



The EU budget for growth, cohesion and agriculture (as % of total expenditures for domestic economic policies) Agreed budget vs. Sapir Report proposal

<i>Budget item</i>	<i>2014–2020</i>	
	<i>Agreed budget</i>	<i>Sapir Report proposal</i>
Growth	15	53
Cohesion	40	41
Agriculture	45	6
Total	100	100

The EU budget for growth, cohesion and agriculture (as % of total expenditures for domestic economic policies)

Agreed budget vs. Sapir Report proposal

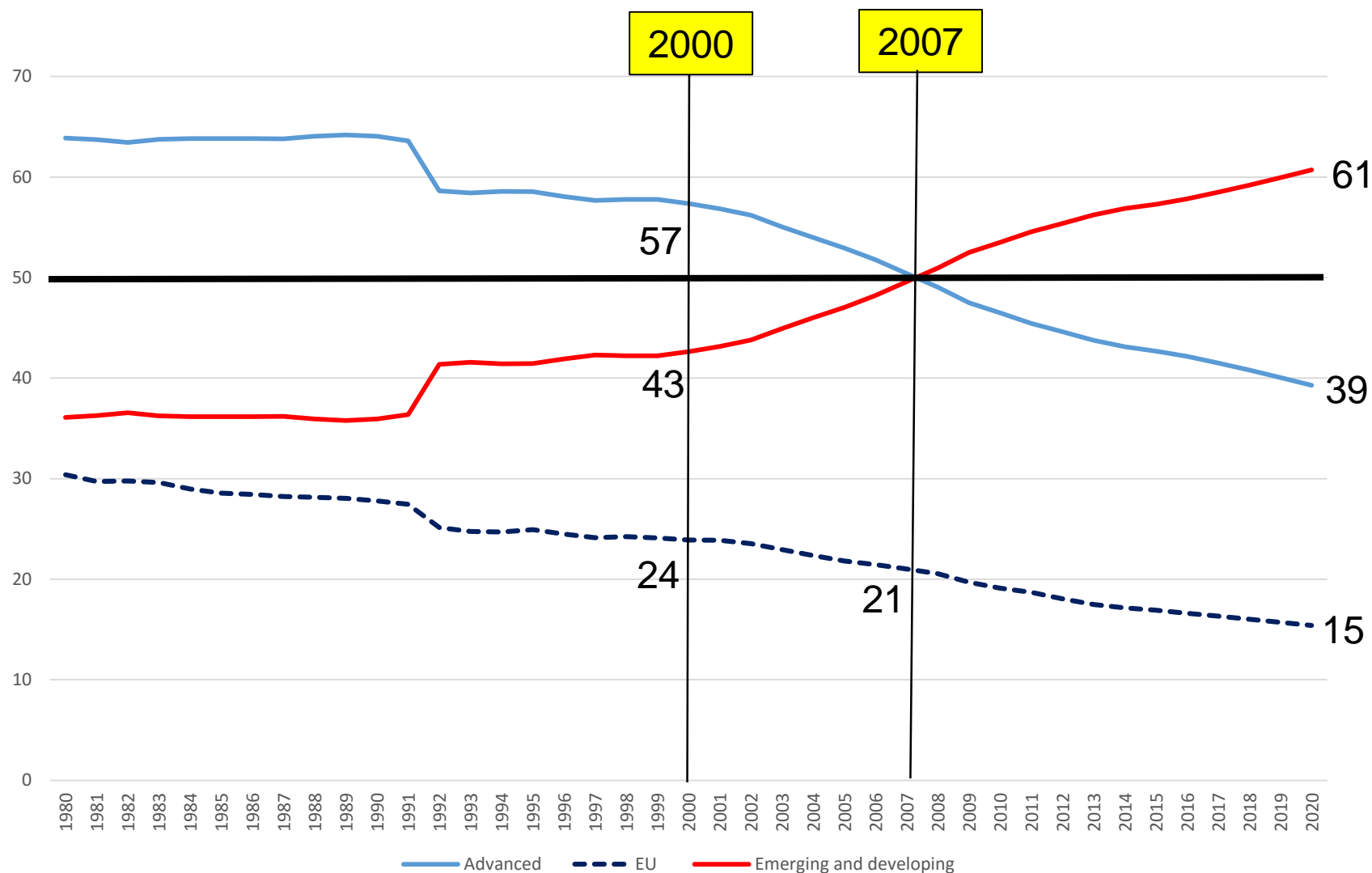
<i>Budget item</i>	<i>2007–2013</i>		<i>2014–2020</i>	
	<i>Agreed budget</i>	<i>Sapir Report proposal</i>	<i>Agreed budget</i>	<i>Sapir Report proposal</i>
Growth	11	45	15	53
Cohesion	41	40	40	41
Agriculture	48	15	45	6
Total	100	100	100	100

With the crisis, challenges have become more acute

- The crisis has reduced Europe's (and mainly EZ) potential output
- Technological change and globalization have accelerated

The crisis has accelerated the relative decline of AEs

Share of advanced vs. emerging and developing economies in global GDP (in PPP), 1980-2020



Yet our capacity to deal with the challenges has reduced

- The state of **public finances** is fairly dismal
- The **ageing of population**
- The crisis has focused **political capital** on **short term** issues

Conclusion: Still the right agenda but it needs to be adapted

- The problem is particularly severe in the EZ Southern periphery
 - » **Obsolete** economic and social model prior to euro adoption
 - » **External debt and competitiveness** problems after euro adoption
 - » **Some correction** of macro imbalances since the crisis
 - » But **problems persist** and **high unemployment** levels

- The core-periphery divide needs to be reduced by combining
 - » Growth-friendly **structural reforms** in the **all EU countries**
 - » Growth-friendly **demand policies** in some **core countries**
 - » Growth-friendly **EU policies** that work on both **demand and supply**
Juncker investment Plan: Money + Single Market. Good, but too small