



# **New challenges for the Euro: Governance for the Monetary Union**

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# "Our early beliefs"

## Expectations two decades ago

### *What we thought would happen*

- Globalisation of capital, not labour
- Low-skilled priced out
- Sharing monetary sovereignty leads to social convergence, eventually
- Stability and efficiency for the EU, redistribution and stabilisation for the MS

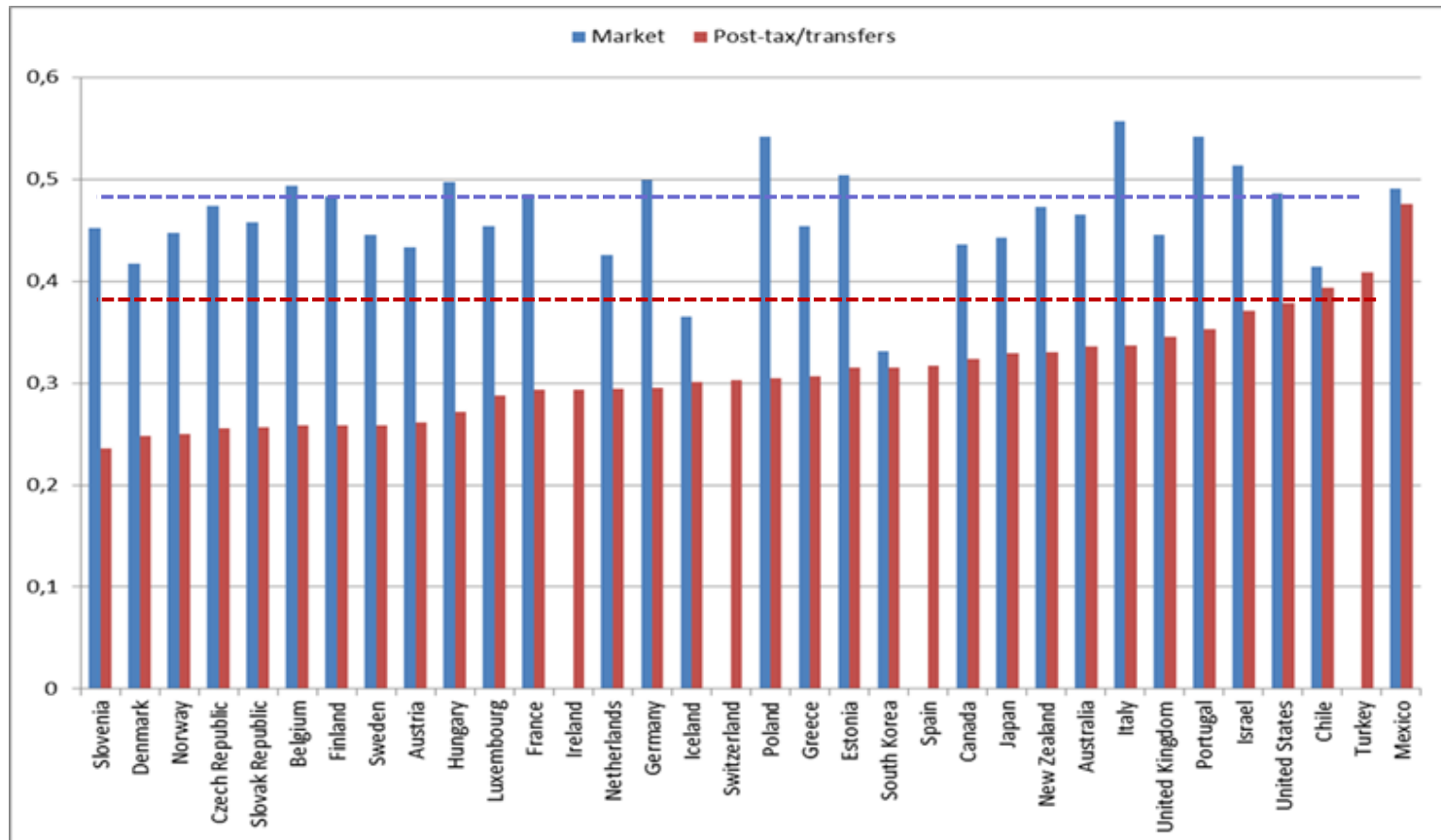
### *What happened instead*

- Immigration perceived as a threat
- Yes, but also stagnation of median incomes
- Divergence in economic structures and social preferences
- The harsh face of Europe is not politically sustainable

# Challenges for Europe

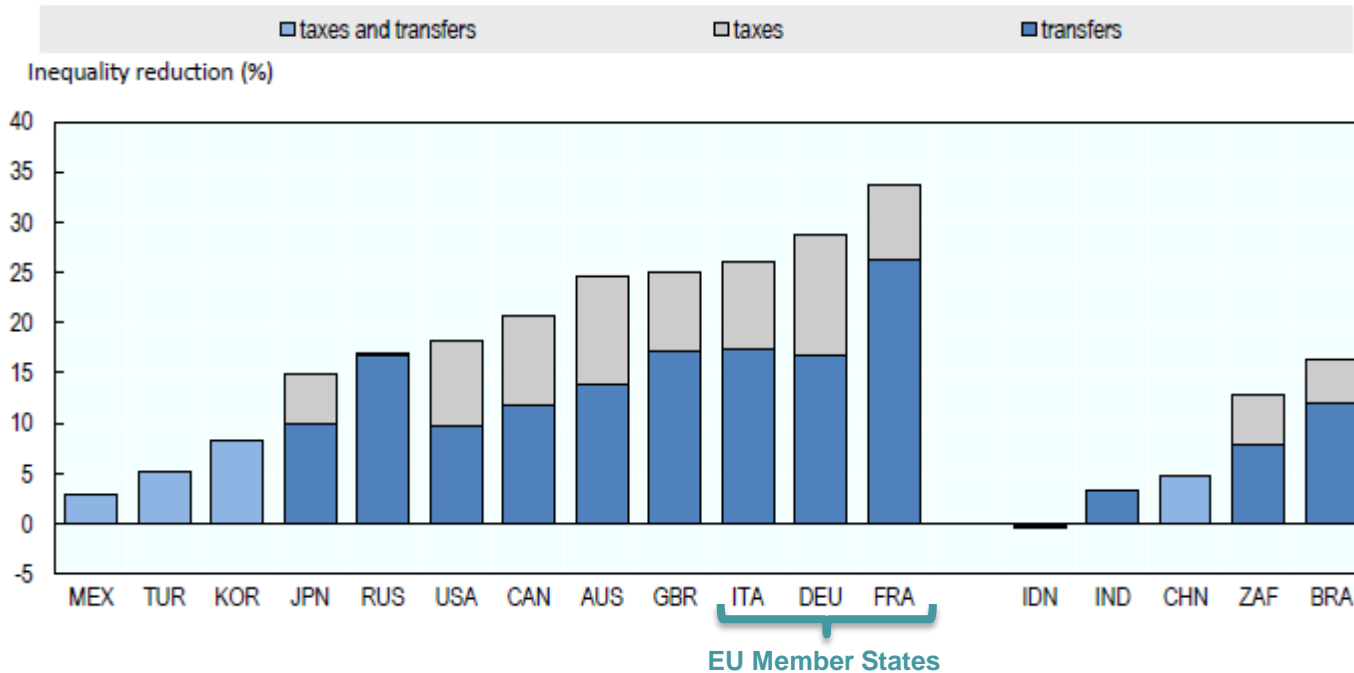
- *Migration and free movement of people cause insecurity*
- *Low productivity growth strains the European social model*
- *New model of convergence wanted*
- *The "Maastricht" policy assignment is under question*

# Does the European social model protect?



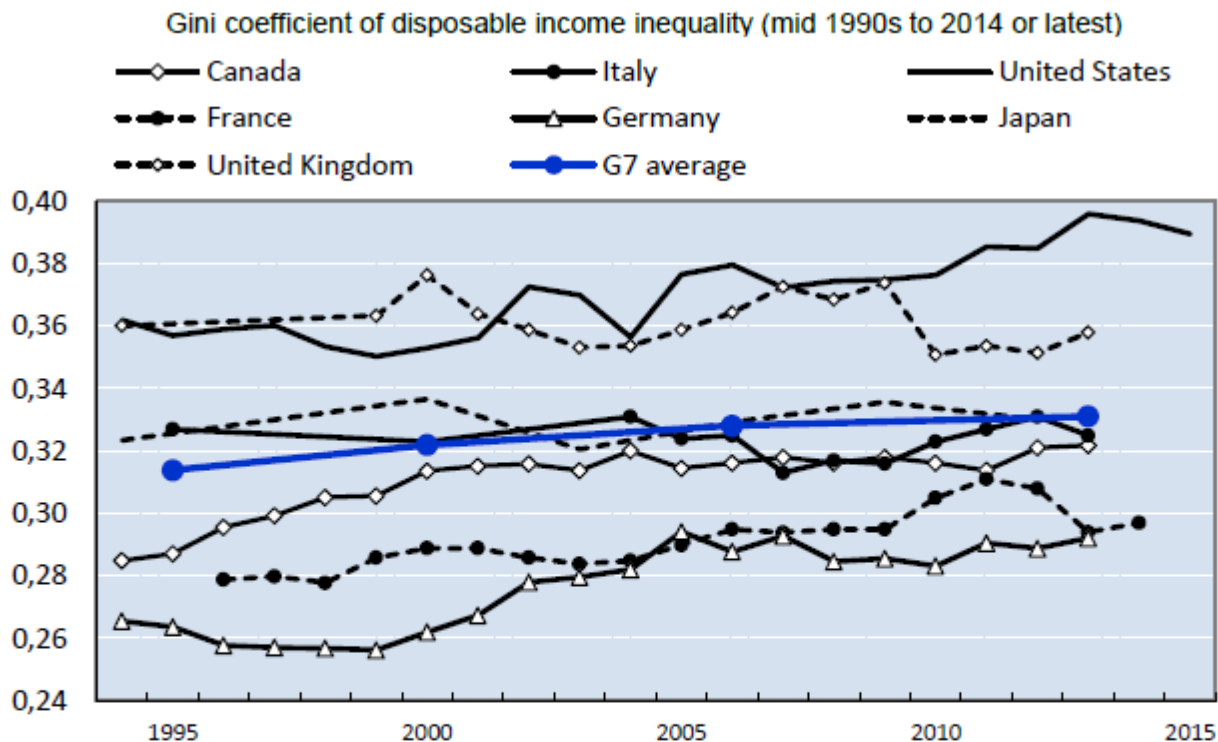
# Does the European social model protect? (continued 1)

Redistributive effect of income taxes and cash transfers, 2014/15 (or latest year available)



Source: OECD IDD (<http://www.oecd.org/els/soc/income-distribution-database.htm>) and provisional data from OECD/Ford joint project. Some of the OECD joint project data is not final and subject to future change.

# Does the European social model protect? (continued 2)



1. Note: Data for USA (2015) and France (2014) are provisional.

Source: OECD Income Distribution Database (IDD), [www.oecd.org/social/income-distribution-database.htm](http://www.oecd.org/social/income-distribution-database.htm), as at 17-January 2017. Secretariat calculations.

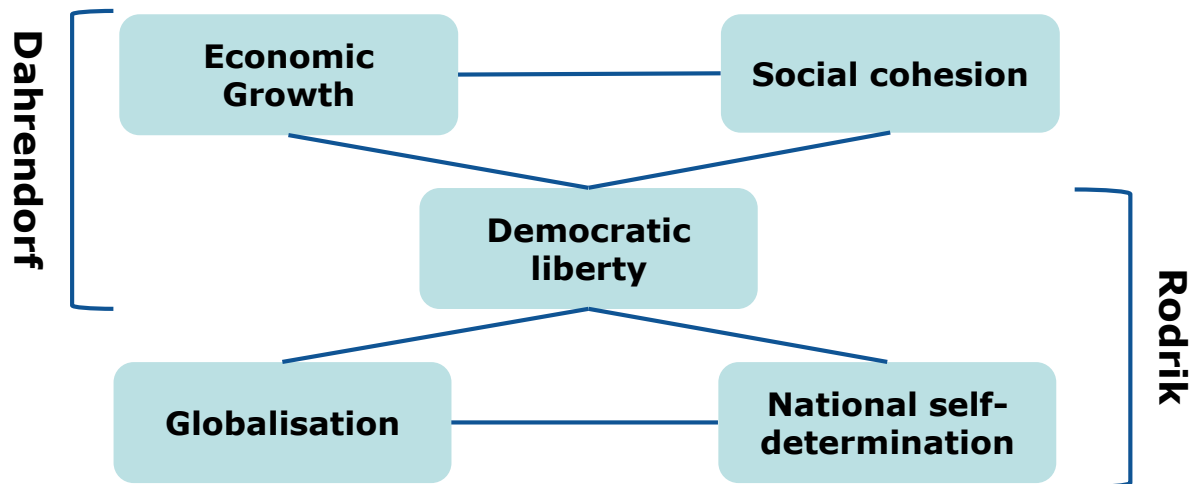
# The impact of integration

## ➤ Beneficial for the economy, but not Pareto-optimal

- It affects relative scarcities of production factors
  - Free (embedded) factor flows in integrated markets, favouring mobile factors
- It propagates (skill-biased) technical progress
  - A globalisation/digital divide, favouring capital and high-skilled labour
- It enhances dynamic agglomeration effects
  - Increasing/high/persistent regional disparities
- It increases competitive pressures/enforces higher market flexibility
  - May negatively affect fair working conditions/protection in the market
  - May undermine rent seeking/rent sharing arrangements
- It limits the room for re-distributional manoeuvre at local level
  - Reduction of enforcement and discriminatory power
  - Enhanced systems competition effects
  - Perception of fiscal rules as a "straightjacket"

## ➤ Consistent with predictions of an "augmented" Heckscher-Ohlin model

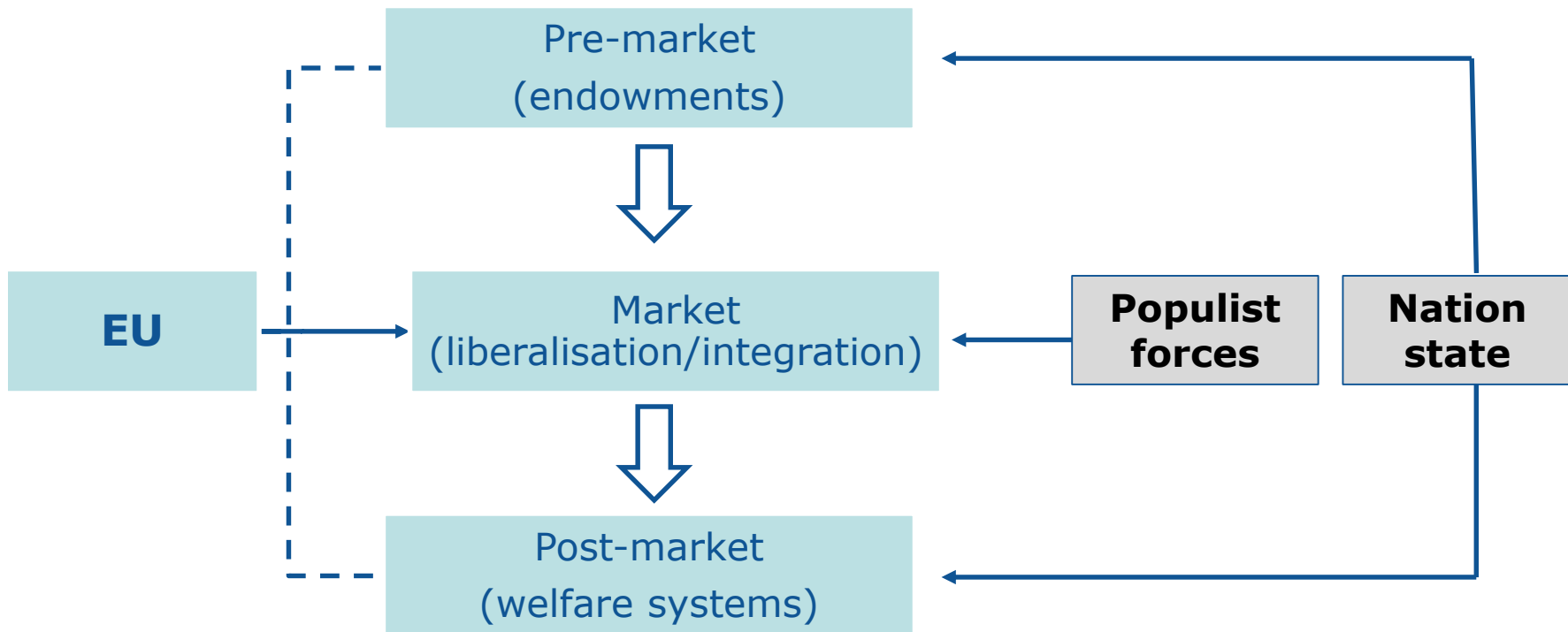
# Rodrik-Dahrendorf quandary



- If globalisation  $\equiv$  economic growth  $\Rightarrow$  risk of loss of social cohesion and national self-determination
- Two views on European integration:
  - (A) Regional globalisation OR
  - (B) Joint response to globalisation
- How to make (B) prevail?



# Aligning social pressures and policy responses



## Pre-market perspective

- The distribution of endowments:
  - Equip people with the resources and skills to succeed in life
  - Access to child care, education and training, health, housing
- Basic principles:
  - Equal opportunities
  - Non-discriminatory
  - Intergenerational fairness (incl. the environment)

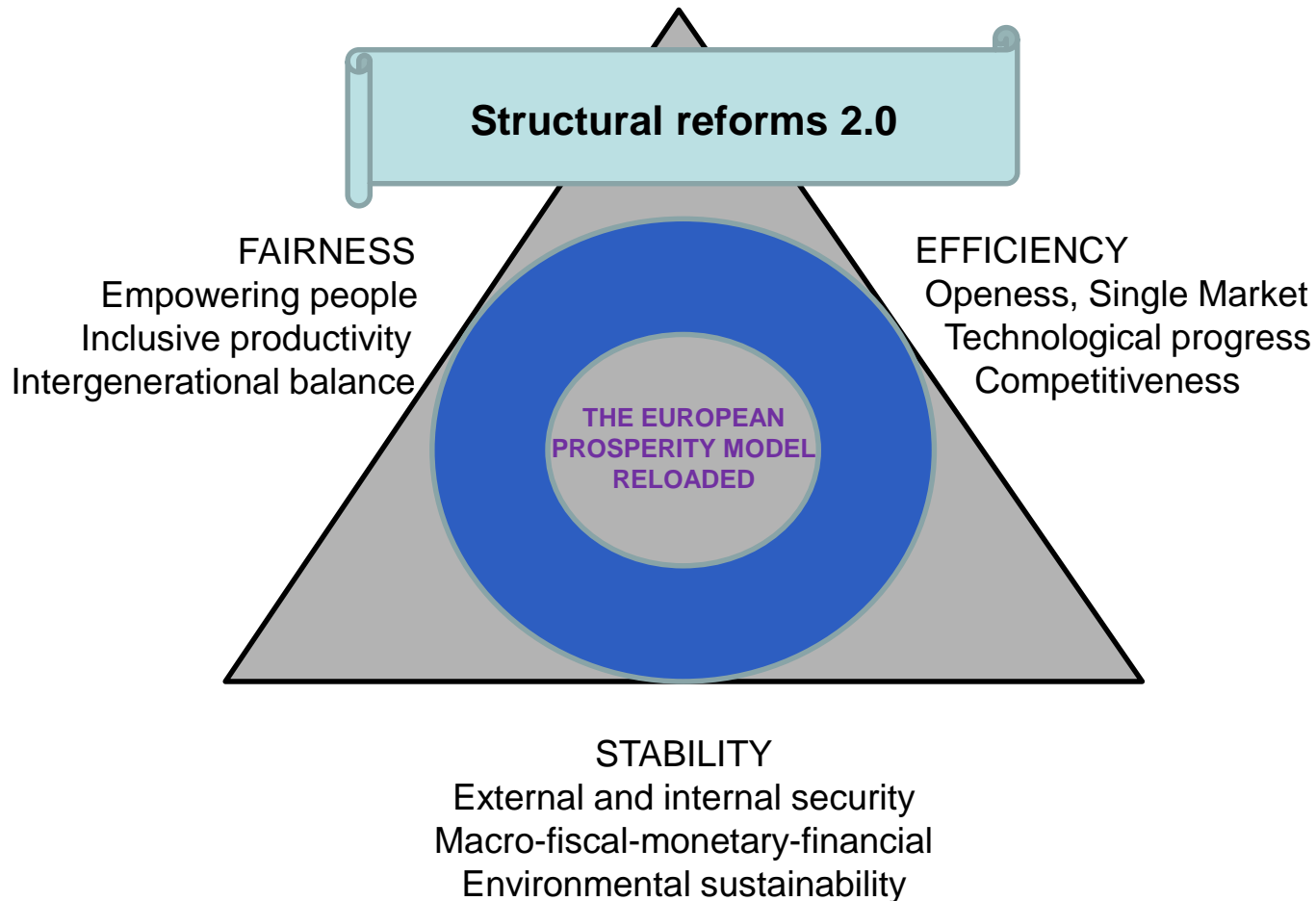
## Market perspective

- Labour market compact
  - Social protection in the marketplace – "Securiflex"
  - Minimum standards – decent job conditions for all types of work
  - Collective rights
- Don't forget the role of product and financial markets

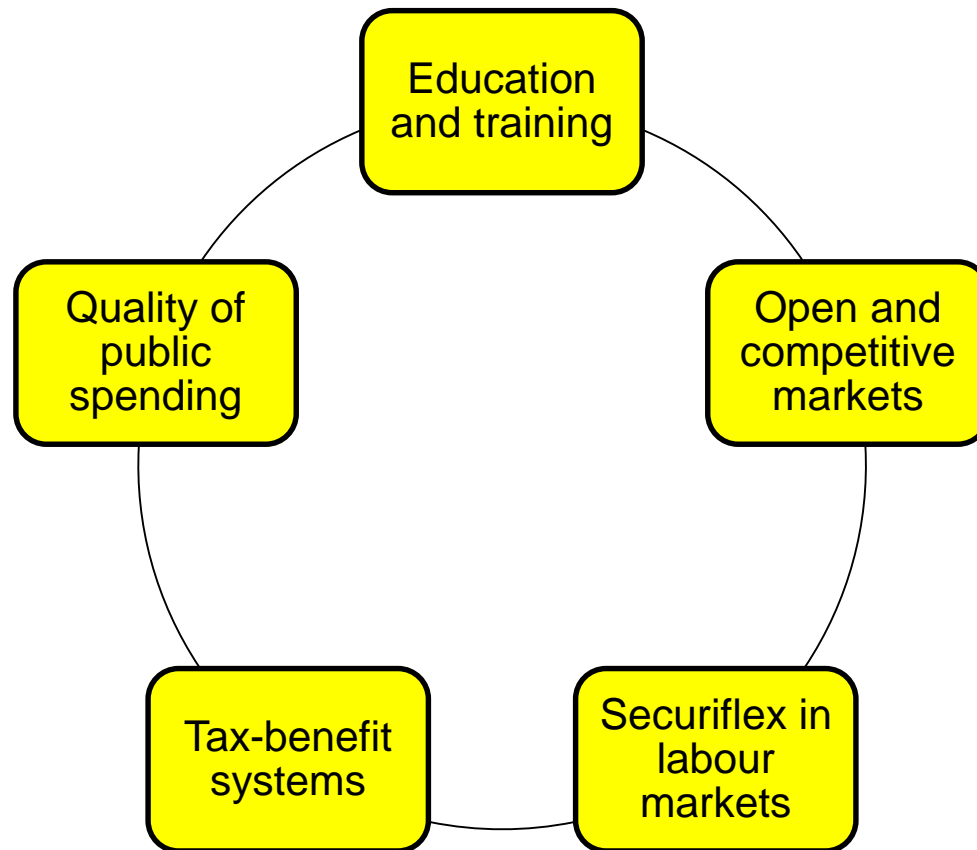
## Post-market perspective

- Redistribution via the tax-benefit system and the provision of public goods – "fairness principles"
- "Efficient" welfare systems and social safety nets
- Collective insurance against the "big risks"
  - Unemployment
  - Health
  - Old-age

# THE EUROPEAN PROSPERITY MODEL



## The 5 main levers of structural reforms 2.0





European  
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PRIORITY AREA	SETS OF ACTION
Fostering investment in people and ideas	<ul style="list-style-type: none"><li>• Strengthen activation and inclusion policies offering lifelong training and re-employment services</li><li>• Prioritise education and training , including early childhood intervention; reduce drop-outs</li><li>• Foster innovation systems, R&amp;D and the smooth diffusion of technological progress</li><li>• Ensure universal and fair access to health care</li></ul>
Adjustment and adaptability for inclusive growth	<ul style="list-style-type: none"><li>• Strengthen industrial relations and collective bargaining structures internalising negative external effects and promoting work-place productivity</li><li>• Embrace open markets and the reallocation of factors of production towards its most productive use</li><li>• Support adaptation and address displacement costs related to globalisation and technological change</li><li>• Tackle labour market segmentation, establish better social protection for non-standard employment</li></ul>
More efficient and inclusive tax-benefit systems	<ul style="list-style-type: none"><li>• Establish/optimize inclusive minimum income schemes</li><li>• Use tax policy to impact market income distribution</li><li>• Shift taxation away from labour, broaden tax bases, increase the progressivity of taxation structures</li><li>• Optimise tax incentives for labour market participation and productivity growth</li><li>• Ensure fair and sustainable pension systems in view of a changing world of work</li></ul>

# Where more Europe and where less

## 1) *Complete EMU*

- **The core of the core cannot remain half-baked: 28-1=19**

## 2) *Focus EU budget on new European public goods*

- **Common migration, securing external borders, TFP-enhancing policies**

## 3) *Ensure vertical consistency between EU and national budgets*

- **Pre-market and post-market consistency**

## 4) *Mainstream distributional considerations into EU policies*

- **Not only the harsh face of Europe**