



Populism and European integration: diagnosis and policy response

Marco Buti

*Director General for Economic and Financial Affairs
European Commission*

XXX Villa Mondragone International Economic Seminar
Rome, University of Rome Tor Vergata
June 25-27, 2018



Outline*

I. Diagnosis: risk of drifting apart

- *Two perspectives: economic and cultural/identitarian*
- *Globalisation and technological change as accelerant on both fronts*
- *Endogenous (non-)convergence*

II. Policy response: bridging the divides

- *Policy inconsistencies and open questions*
- *Updating the EU task book*

** Personal views, not to be attributed to the European Commission*

I Diagnosis: risk of drifting apart

Two perspectives

Economic insecurity

- Rising **income and wealth inequality** as well as **economic insecurity** fuels popular resentment of the political elites

Cultural-identitarian

- Reaction against **progressive cultural change** resulting from intergenerational shift towards values such as cosmopolitanism and multiculturalism

"Immigration fears" related to both facets
Rural/urban divide as a common thread

youngsters having lost hope, low-waged unskilled **workers**, long-term **unemployed**, households dependent on **shrinking social benefits** turn against neoliberal elites

less educated, older generations and right-wing authoritarians react to erosion of their privileges and societal status

First accelerant: globalisation



- *Globalisation: beneficial on aggregate, but not Pareto-optimal: there are winners and losers*
 - *Favours mobile factors; capital and high skilled labour*
 - *Enhances dynamic agglomeration effects BUT increasing regional disparities*
 - *Increases competitive pressures BUT may negatively affect fair working conditions/protection in the market*
 - *Revenue mobilization complicated by increased mobility of production factors, profit shifting and tax competition → less room for re-distributional manoeuvre at the national level*
- *We have underestimated the related large "side effects"*
 - *Distributional impact along the skills dimension and the spatial differentials underestimated, treated with benign neglect*
 - *A sympathetic/uncritical view of downhill capital flows*
 - *Systemic risk from unbridled financial markets*
 - *Labour treated as immobile, so migration seen as "manageable" at national level*
 - *Winner-takes-it all dynamics, stagnation of median income*
 - *Real/perceived loss of control vis-à-vis big business, financial sector*

Second accelerant: "biased" technological change

- *Advances in ICT biased against low-skill labour-intensive sectors*
- *Raising interconnectivity, coupled with a fall in transportation cost*
- *Push towards outsourcing, integrated value-added chains*
- *Again, focus on overall gains, reallocation needs acknowledged, **but** underestimation/benign neglect/too little support of adjustment*
- *Distribution of power and income change in favour of capital and high-skilled/digital-literate labour, "mobile urban elites"*

And the next wave?

- *Digitalisation, automatization, robotics, AI, biotech ...*
- *Manual, cognitive-repetitive tasks at risk, job polarisation*
- *Digital goods: scalable, zero-marginal cost, monopolistic competition*
- *Potentially highly disruptive*

Endogeneous convergence: EMU

Launching the euro – sharing monetary sovereignty

- *Single currency reduces transaction costs and exchange rate risks; encourages cross-border trade and investment; and as such promotes market integration in the EMU*
- *Hopes for endogenous moves towards OCA*
- *Too benign views of downhill capital flows, ignored the misallocation of capital and the built-up of internal imbalances*
- *Allocation and agglomeration effects led to structural divergence and consolidated "traditional" national preferences*
- *Fiscal adjustments perceived to be imposed from "outside"*
- **The crisis has left a heavy toll**
 - *High political, economic and social cost, stratified by age/region*
 - *Rise of a north-south/creditor-debtor divide, rooted in historical legacy*
 - *Loss of trust between Member States and vis-à-vis the EU institutions*
 - *Need to urgently address the EMU design gaps*

Endogenous convergence: Enlargement

EU enlargement towards Central and Eastern Europe

- *The "convergence machine" did work, leading to significant catching-up growth has occurred*
- *But, it did not go beyond economic convergence and failed to extend to the adoption of EU institutional structures/norms/values*
- *Downplayed the significance of large income differentials for the workings of the internal market*
- *We underestimated emerging frictions and tensions*
 - *An east-west divide along EU "rights and obligations"*
 - *Clashing perceptions of "EU entitlements and national sovereignty" vs. "unfair competition and lacking solidarity"*
 - *Single market tensions, multi-speed EU*

II Policy responses: bridging the divides

Divides at global and EU level and their risks

DIVIDE

Global

Skills/digital

Intergenerational

Income and wealth

Spatial/regional

Cultural/identity

RISK

=> Economic warfare, protectionism

=> Job polarisation, inequality

=> Lost generation(s)

=> Popular discontent, growth

=> Growth gaps, exclusion

=> Political fragmentation

Revisiting the EU strategy: 4 avenues

- *Focus on delivering the common public goods in need of well-defined EU value-added (external border security, migration, trade, ...) => MFF proposals*
- *Re-establish the core values of the European social model and mainstream distributional considerations into EU policy designs => European pillar of social rights*
- *Complete EMU as (and in) a way to overcome the creditor/debtor divide => EA summit as a start*
- *Ensure transparency and accountability over the course of decision-making => towards next European elections*

Deepening EMU, a process to be completed by 2025

- *October 2017: Communication "**Completing the Banking Union**"*
- *December 2017: "**EMU package**"*:
 - Transformation of the ESM into a European Monetary Fund
 - Creation of a dedicated euro area budget line in the EU budget
 - ✓ Stabilisation function
 - ✓ Structural reform assistance
 - ✓ Convergence instrument for euro pre-ins
 - ✓ Backstop for the Banking Union
 - Integration of the substance of the TSCG (balanced budget rule) into EU law
 - European Minister of Economy and Finance

**Thank you very much
for your attention**