"Uneasy Calm: Fixing Europe's Economic and Institutional Woes"

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Harvard University, Center for European Studies, 1 November 2016
Outline

1. Slowly exiting the worst crisis since the 1930s
2. What do citizens want? "More" or "Less" Europe?
3. Overcoming political inconsistencies
4. What now?
1. SLOWLY EXITING THE WORST CRISIS SINCE THE 1930s
A difficult transition

- Slow recovery and lower growth
  - Euro area vs US
  - Risk of debt/ deflation trap?
  - Weak and declining TFP

- Weak banks
  - High NPLs
  - Structural weaknesses

- High debt legacy
  - Low fiscal space
  - Deleveraging still ongoing
Slower growth in the euro area than in the US – but substantial differences among members

Source: AMECO and ECFIN calculations.
Inflation

Source: AMECO – European Commission
The legacy of debt

Public debt before and after the crisis (%GDP)

Public and private debt in the EU, average (%GDP)

Source: AMECO and ECFIN calculations.
Inequality and Welfare

Global income growth from 1988 to 2008

- Rising incomes in emerging economies, mainly China
- Booming global elite
- Decline of developed world middle-class
- Very poorest locked out of growth

Prior to crisis
Today (2015)

NEET rate, age group 15-24

Source: AMECO and ECFIN calculations.
Will the recovery continue?

Uncertainty remains extremely high.
Risks have intensified in recent months

External risks
+/- EME-related, China
+/- Rebound in non-EU advanced economies
- Increasing protectionism.
+/- Geopolitical tensions

Domestic risks
- NPL, credit quality, banks
+/- Reforms delayed
- Vulnerable economies
- Deflation risks

Particular impact of Brexit:
Economic risks: linked to the terms of the UK’s exit (trade, migration, FDI,…).
Political risks: Risks to the integrity of the EU and the euro area. Possibly a watershed for protectionism and deglobalisation.
2. WHAT DO CITIZENS WANT? "MORE" OR "LESS" EUROPE?
Further steps towards a more political union?

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<th>FR (%)</th>
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<th>ES (%)</th>
<th>BE (%)</th>
<th>PL (%)</th>
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<tbody>
<tr>
<td>Creation of a European army</td>
<td>66</td>
<td>47</td>
<td>59</td>
<td>47</td>
<td>65</td>
<td>57</td>
</tr>
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<td>Creation of a European Finance Minister</td>
<td>64</td>
<td>58</td>
<td>65</td>
<td>64</td>
<td>67</td>
<td>60</td>
</tr>
<tr>
<td>Election of an EU President by direct universal suffrage</td>
<td>63</td>
<td>71</td>
<td>67</td>
<td>65</td>
<td>68</td>
<td>71</td>
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*IFOP, July 2016 (fieldwork: late June/ early July)*
Trust in the future of the EU?

Lehman Brothers
EFSF
Banking union decision + "Whatever it takes" (Draghi)
3. OVERCOMING POLITICAL INCONSISTENCIES
First inconsistent trinity: political integration

Deep political integration

More European federalism and a more accountable EU

Inter-governmental decision-making and concern over democratic deficits

Traditional democratic processes

Nation-state institutions

Domestic checks and balances, national vetoes (EU before the Single European Act)
Second inconsistent trinity: economic and social viability

Unambitious structural reforms

Gradually erosion of the European welfare model

Unsustainable levels of public debt

Sound fiscal policies

Sustainable welfare models

Lack of job creation and growth
Third inconsistent trinity: adjustment objectives in the euro area

- Inflation persistently below target
- Lack of rebalancing
- Persistent debt stifling growth
- Sustainability of high debt burdens
- Competitiveness gains in vulnerable economies
A new political synthesis

- Structural reforms to boost potential growth
- More balanced policy mix
- Strengthening EU-dimension of policy making
4. WHAT NOW?
Expectations 20 years ago

- Globalisation of capital – not labour
- Low skilled priced out while globalisation and technology progress
- Faith in multilateral solutions
- Sharing sovereignty would bring convergence of social preferences and mutual trust
- European inclusive welfare model protects from inequality

... AND NOW?
Bridging different positions

Solidarity

Discipline

All MS (symmetric adjustment)

Only vulnerable MS (asymmetric adjustment)

Short-term response

Long-term reform

Secondary law

Treaty changes

Discretion

Rules

Community framework

Inter-governmental

Demand (cyclical/macro)

Supply (potential growth struct. ref.)

Political Union

Euro area

European Union

Maintaining sovereignty

Political Union

Euro area

European Union
European Policy Priorities

- Implement a strategy for inclusive growth
  • Policy mix for investment
  • Reforms and distribution effects

- New EU public goods
  • Security and defence
  • Rethink EU resources

- Rebuild trust to complete EMU
  • Risk sharing and risk reduction
  • Towards the White Paper of March 2017