Europe’s Incompatible Trinities

Is the recasting of economic governance of Europe beset by intractable economic, political and institutional conflicts?

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Outline

1. A difficult transition
2. Putting Europe into perspective
3. Incompatible trinities
4. The way forward: what and how?
1. A DIFFICULT TRANSITION
A difficult economic transition

- Slow recovery and lower growth
  - *EA 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*
The crisis hit EMU in its infancy: fixing the engine while flying – steps done so far

• **Crisis management**
  • EFSF + EFSM
  • European Stability Mechanism

• **Crisis prevention**
  • European semester
  • Fiscal framework reform
  • Macroeconomic Imbalance procedure
  • Macroprudential supervision
  • Banking Union (single supervision + resolution)
Broader tensions

• Declining trust in Europe
• Brussels as scapegoat
• Rising populism

… but citizens do not necessarily demand less Europe.
Further steps towards a more political union?

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<th>Issue</th>
<th>FR (%)</th>
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<th>IT (%)</th>
<th>ES (%)</th>
<th>BE (%)</th>
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2. PUTTING EUROPE INTO PERSPECTIVE
"Our early beliefs"
Expectations two decades ago

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

… AND NOW?
3. INCOMPATIBLE TRINITIES
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

- Low potential growth
- Gradually eroding 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 Eurozone

- 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

- Reforms to boost potential growth
- More balanced policy mix
- Strengthening EU-dimension of policy making

European Commission
4. THE WAY FORWARD: WHAT AND HOW?
### New European Policy Priorities

| Structural Reforms 2.0                        | • Productivity / TFP  
|                                              | • Human capital  
|                                              | • New welfare and financial systems |
| More balanced policy mix                     | • Unburdening the ECB  
|                                              | • Fiscal capacity and fiscal rules  
|                                              | • Private and public risk sharing |
| Rethinking EMU architecture                  | • New European public goods  
|                                              | • Rebuilding trust to complete EMU  
|                                              | • Vertical coherence |
Bridging different positions

**Economic**
- Solidarity
- Short-term response
- Discretion
- Demand (cyclical/macro)
- National sovereignty
- Discipline
- Long term reform
- Rules
- Supply (potential growth struct. ref.)
- Political Union

**Institutional**
- All MS (symmetric adjustment)
- Only vulnerable MS (asymmetric adjustment)
- Secondary law
- Treaty changes
- Community framework
- Inter-governmental
- Euro Area
- European Union
Differences of opinions contributed to the "Ultima Ratio" Logic

DENIAL

"It's an American crisis, not an EA one"

PUT YOUR HOUSE IN ORDER

"Correct fiscal profligacy in peripheral countries"

AKNOWLEDGEMENT OF A COLLECTIVE PROBLEM, BUT TOO LITTLE TOO LATE

Greek Loan Facility

BOLD SOLUTIONS FACING THE ABYSS

ESM, BU
"Whatever it takes"

BACKTRACKING WHEN SITUATION IMPROVES

Current phase?
If globalisation ≡ economic growth => 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

EU

Pre-market (endowments)

Market (liberalisation/integration)

Post-market (welfare systems)

Populist forces

Nation state