



# Europe's Incompatible Trinities

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

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**London School of Economics and Political Science,  
European Institute, 21 November 2016**

# 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?

	FR  (%)	DE  (%)	IT  (%)	ES  (%)	BE  (%)	PL  (%)
Creation of a European army	66	47	59	47	65	57
Creation of a European Finance Minister	64	58	65	64	67	60
Election of the EU President by direct universal suffrage	63	71	67	65	68	71

## 2. PUTTING EUROPE INTO PERSPECTIVE



# "Our early beliefs"

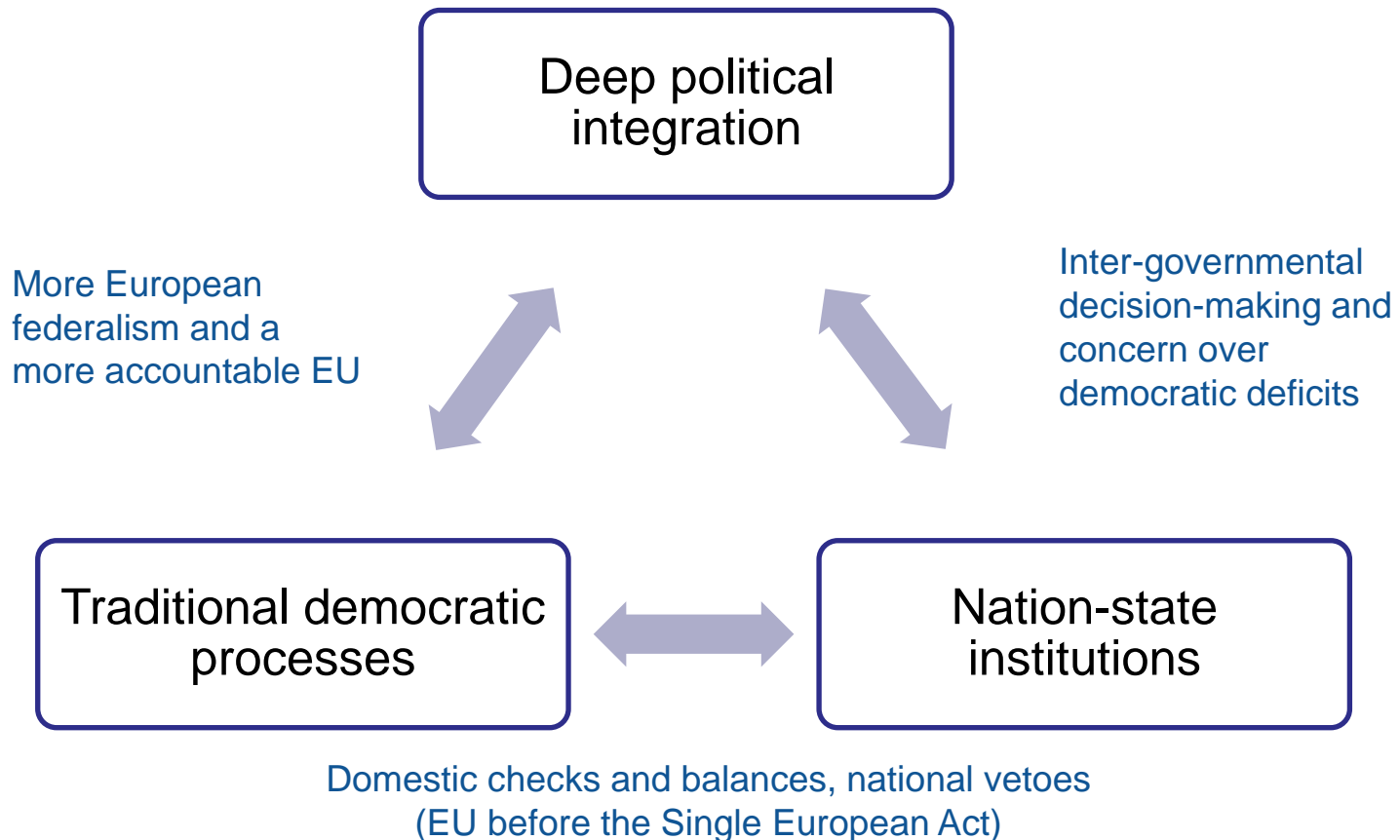
## Expectations two decades ago

- 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

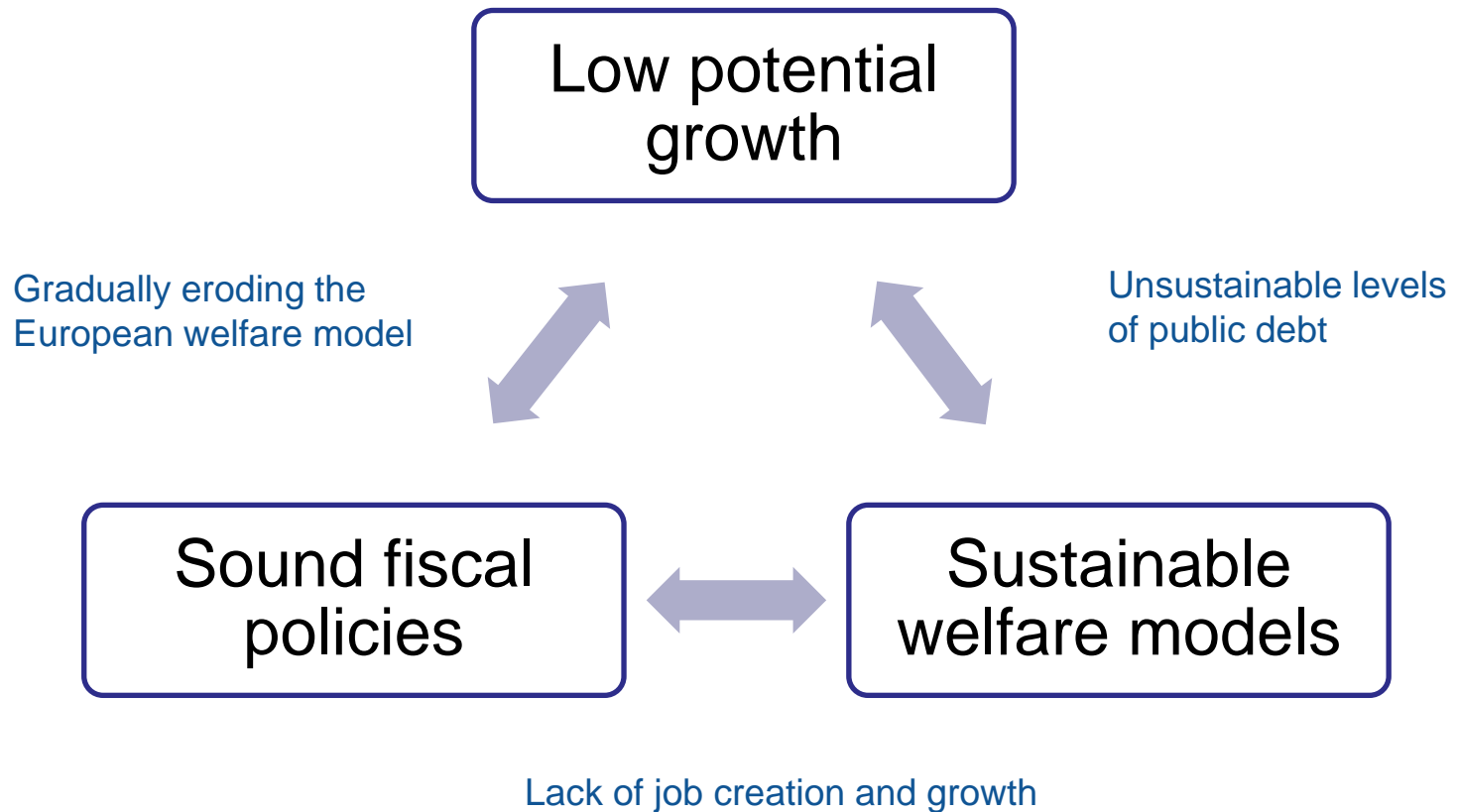
... AND NOW?

# 3. INCOMPATIBLE TRINITIES

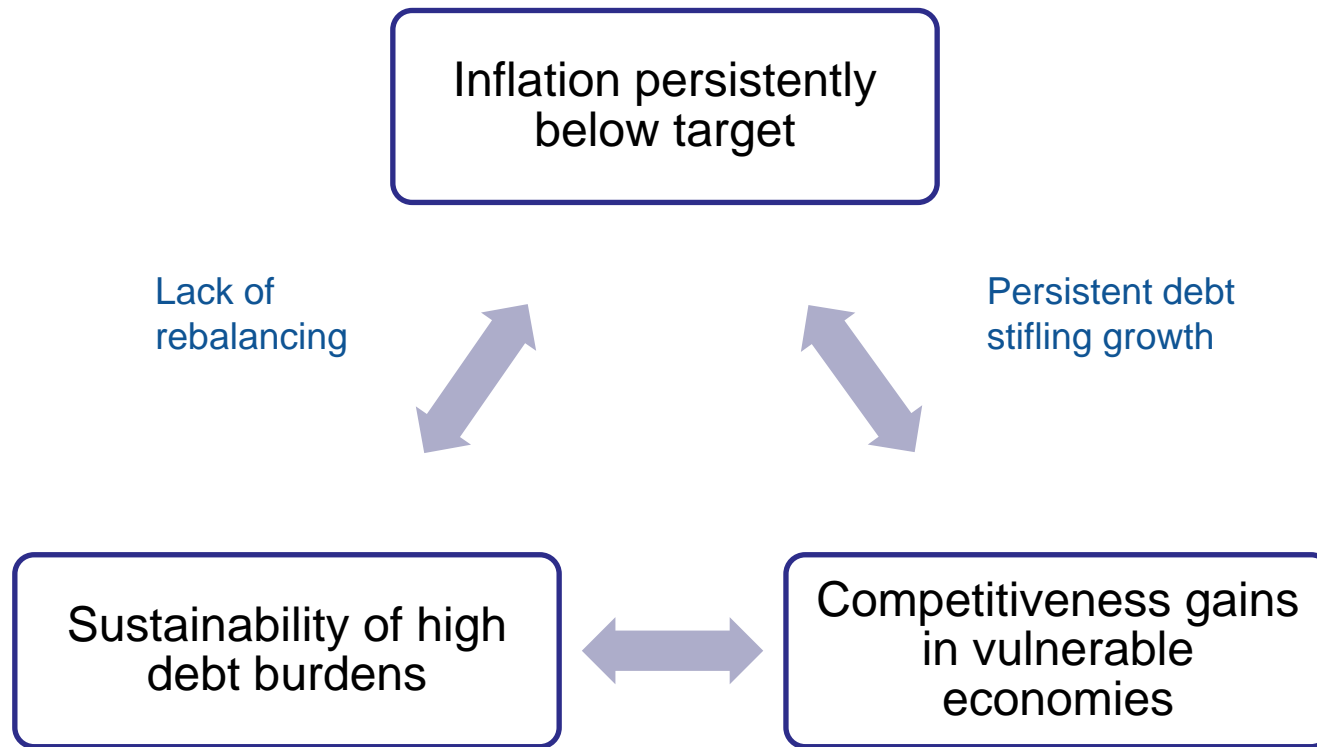
# First inconsistent trinity: political integration



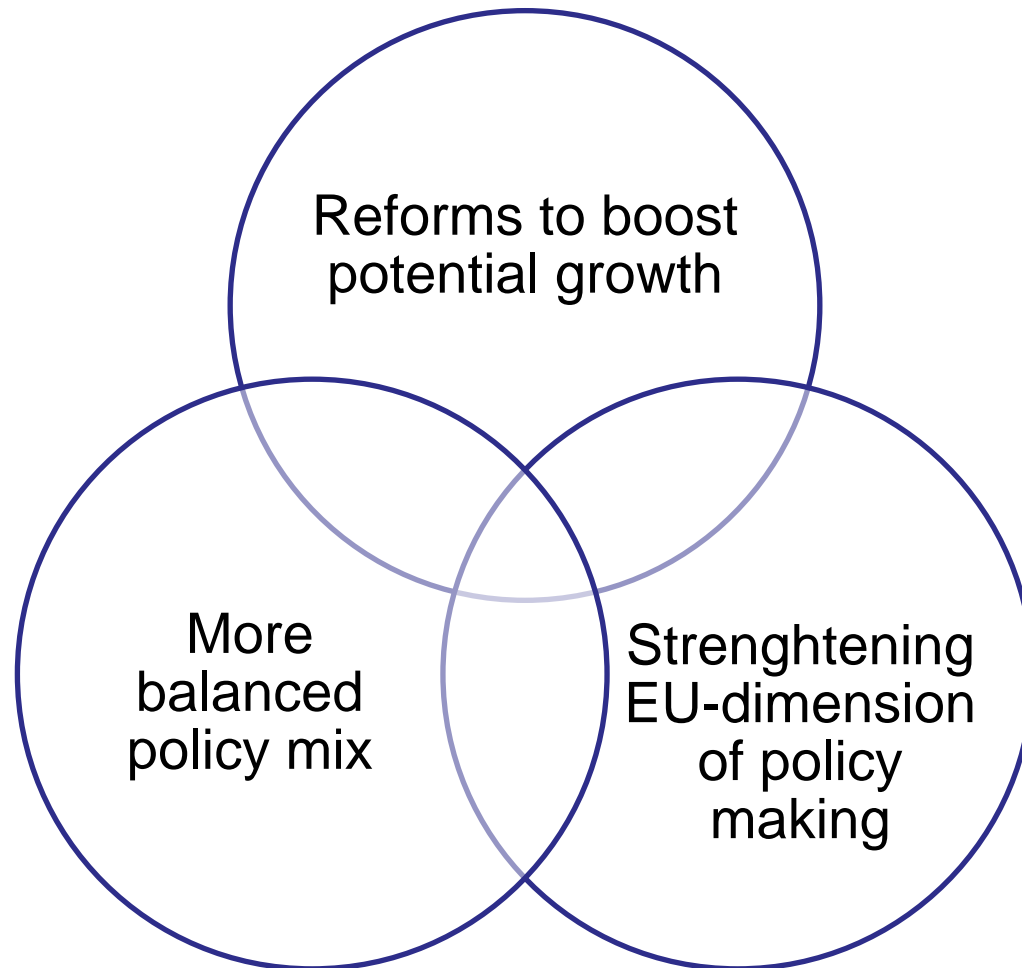
## Second inconsistent trinity: economic and social viability



# Third inconsistent trinity: adjustment objectives in the Eurozone



# A new political synthesis



# 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

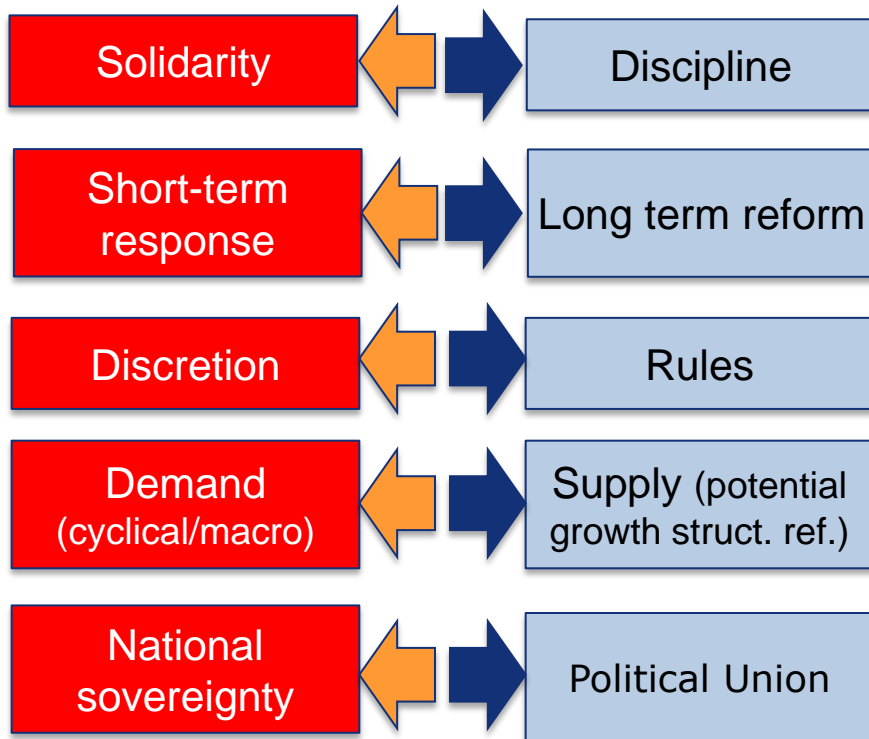
## Rethinking EMU architecture

- New European public goods
- Rebuilding trust to complete EMU
- Vertical coherence

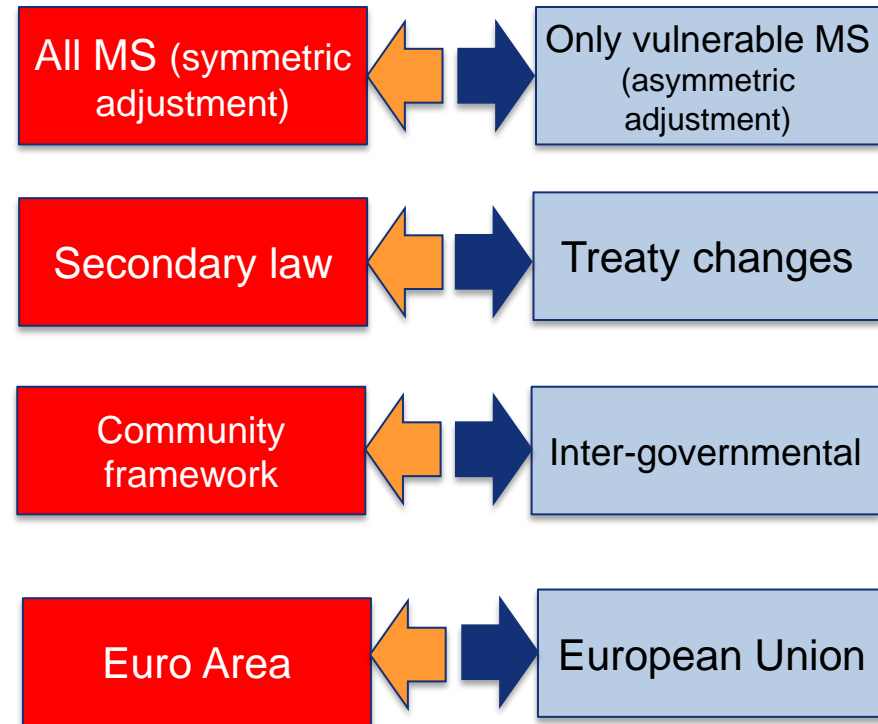


# Bridging different positions

## Economic



## Institutional



# 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"



**ACKNOWLEDGEMENT OF A COLLECTIVE  
PROBLEM, BUT TOO LITTLE TOO LATE**

Greek Loan Facility



**BOLD SOLUTIONS FACING  
THE ABYSS**

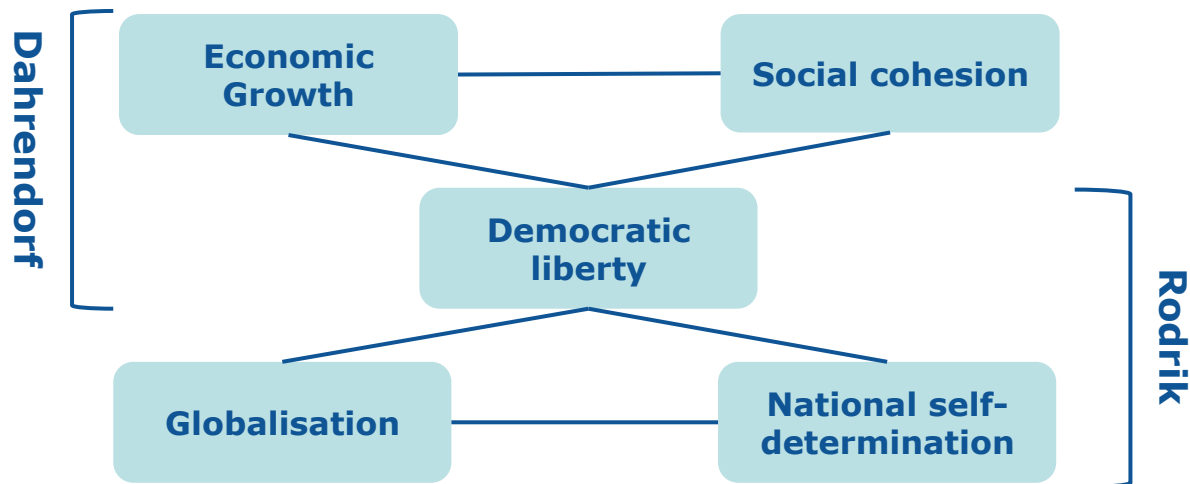
ESM, BU  
"Whatever it takes"



**BACKTRACKING WHEN SITUATION  
IMPROVES**

Current phase?

# 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

