EU Policies for Growth
...and the role for EMU unemployment insurance

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What is needed for growth?

- Not doing „austerity”
- Short-term: counter-cyclical macroeconomic stimulus
- Long-term: increasing endogenous growth potential (competitiveness)
  - EU tried 2 long-term programs: Lisbon Strategy, Europe 2020 Strategy
  - Limitations:
    - Economic governance competences modest (➔ European Semester)
    - Short-term measures can contradict long-term objectives
austerity
/əˈstɜːrəti,ɔːˈstɜːrəti/

noun

1. sternness or severity of manner or attitude.
   "he was noted for his austerity and his authoritarianism"

2. difficult economic conditions created by government measures to reduce public expenditure.
   "the country was subjected to acute economic austerity"
What is austerity for economists?

• Simon Wren-Lewis: “a fiscal contraction that causes a significant increase in aggregate unemployment.”

• Mark Blyth: “a form of voluntary deflation in which the economy adjusts through the reduction of wages, prices, and public spending to restore competitiveness, which is (supposedly) best achieved by cutting state’s budget, debts and deficits.”

• Barry Ritholtz: “the desire to slash government spending and cut deficits during a time of economic weakness or recession”
Alternatives to (over-)using „austerity”

• --“fiscal consolidation” should be preferred when government policy addresses a major fiscal imbalance (debt or deficit) through either cuts or revenue increases (potentially but not necessarily leading to weakening economic performance)

• --“internal devaluation” should be preferred when a combination of various measures (public expenditure cuts, wage cuts, pension cuts) is used as a substitute to currency devaluation with the intention to gain short-term competitiveness

• --“stability bias” should be used when in a system of economic governance (fiscal and monetary) stability appears as high priority (more and stronger instruments supporting it than economic growth and employment)

• --“pro-cyclical fiscal policy” should be preferred when governance ignores the business cycle and fiscal measures amplify instead of mitigating it (e.g. a reduction of budget deficit either through cuts or tax increases leads to weaker growth or recession)
Profiling the eurozone crisis

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Design flaws in EU architecture

- Paul De Grauwe (LSE) common roots of refugee crisis and eurozone debt crisis
- Maastricht / Schengen: free movement established between countries without safety/security infrastructure and instruments for crisis response /stabilisation
- Schengen: common internal security, asylum policy and border management lacking
- Maastricht: fiscal capacity and financial regulation remained with member states
  - In times of crisis: convergence replaced by divergence in euro area
Economic growth in US and EU (1990-2014)

U.S. and European Union economic growth mirror one another
Gross domestic product, in constant prices, 1990 to 2011*

*Estimates start after 2010
Source: International Monetary Fund, World Economic Outlook Database, April 2011
USA vs. EU countries: uneven recovery
Divergence in unemployment rates, mainly within euro area

Source: Eurostat, EU-LFS; DG EMPL calculations.
Note: EA north and core: AT BE DE FI FR LU NL, EA south and periphery: EE EL ES IE IT CY MT PT SI SK LV non-EA north: CZ DK PL SE UK, non-EA south and periphery: BG HR LT HU RO
Rationale for EMU fiscal capacity

- EMU born with serious design flaws:
  - uniform fiscal rules (and centralised monetary policy) *without* common fiscal capacity, risk sharing or transnational fiscal transfers; absence of counter-cyclical capacity (Joseph Stiglitz)
  - risk of *currency crises* eliminated but risk of *fiscal crises* increased (Paul De Grauwe)
- Crisis experience:
  - financial fragmentation; economic and social divergence
  - social problems generate spill-over effects on other members of euro area (e.g. falling demand, unwelcome migration)
  - deterioration of human capital, disruption of national welfare systems, loss of growth potential (mainly in countries of periphery)
  - risk of destabilisation and disintegration (in the entire union)
Elements of an EMU fiscal capacity

• **Eurozone finance minister** (JDI) – optimising fiscal space for the entire eurozone as opposed to parallel national objectives
• **Eurozone investment fund / growth fund** (semi-automatic „Juncker Plan” with strong transfer component)
• **Automatic stabilisers**, i.e. built-in instruments to counter „asymmetric shocks” and resulting imbalances with rule-based, conditional and temporary fiscal transfers
  • Impact channel: targeted and temporary transfer → supporting aggregate demand → economic activity → employment → social cohesion in zones of economic downturn (…lacking autonomous fiscal/monetary policy)
Options for automatic stabilisers

- **Automatic income support** (based on „output gap”)
  + certainty of legal base under current Treaty
  - lack of social focus

- **Reinsurance** of national unemployment insurance funds (transfers triggered by major crises)
  + stronger visible impact at times of crisis
  - lack of constant stabilisation, trigger may be set too high

- **Partial pooling** of unemployment benefit systems
  + strong connection of recipients with EU solidarity
  + no delays at all
  - greater need for partial LM harmonisation (could be a +)
Both reinsurance and partial pooling...

...deliver:

- **economic stabilisation** (helping faster recovery through aggregate demand channel)
- **social stabilisation** (less unemployment and poverty at times of recession)
- **institutional stabilisation** (better enforceability of EMU fiscal rules; greater legitimacy)

...require:

- **acceptance of limited** (rule-based, conditional etc.) transfers
- **limited harmonization** of labour markets and related institutions
- **transparent governance + stakeholder involvement** (to ensure balance between European solidarity and national responsibility)
Key questions in EMU debates

- **Is fiscal capacity really the next step in EMU reform?** (proxies and byways: EFSI, CMU, QE, competitiveness councils etc.)
- **Acceptance of transfers; fear from moral hazard** (EuCo already circled around conditional transfers /”CCI”/ in 2013)
- **Borrowing capacity** (greater impact linked to inter-temporal stabilisation function)
- **Degree of harmonisation needed in case of automatic fiscal stabilisers** (depends on chosen model but not too much in any case)
- **Role of social partners** (possibility in governance; controlling adjustment tools)
Concluding remarks (1.)

• Language is important: for accurate analysis and potentially for developing policy alternatives as well. Using austerity as a blanket concept does not help finding the ways to undo austerity, especially in the EMU.

• The EU economic architecture suffers from a stability bias, which has been associated with the Maastricht model ever since its inception. Stability and growth both have their legitimate place in economic policy, but within the EU their balance is not right and calls for reform.

• The rule-based nature of EU economic governance puts limitations to dealing with cyclicality as well as asymmetry. These limitations make it hard to design and implement robust recovery policies in case of crises, which in turn erode the long-term growth potential of the Eurozone.
• The EU’s economic challenge is not competitiveness in general but internal imbalances (and North-South asymmetry in particular)
• The weakness of the EMU recovery capacity is greater problem than the long term growth potential („competitiveness”) of the EU economy. Nevertheless, policies for „smart, sustainable and inclusive growth” have to be pursued at EU level
• The EU can and will live with significant imbalances but divergence can result in disintegration and lasting stagnation → EMU reform needed
• Reducing imbalances and inequalities can help improving EU growth performance (both short and long term)
• Unemployment insurance is a well developed idea for fiscal stabiliser
• Thank you for your attention!