

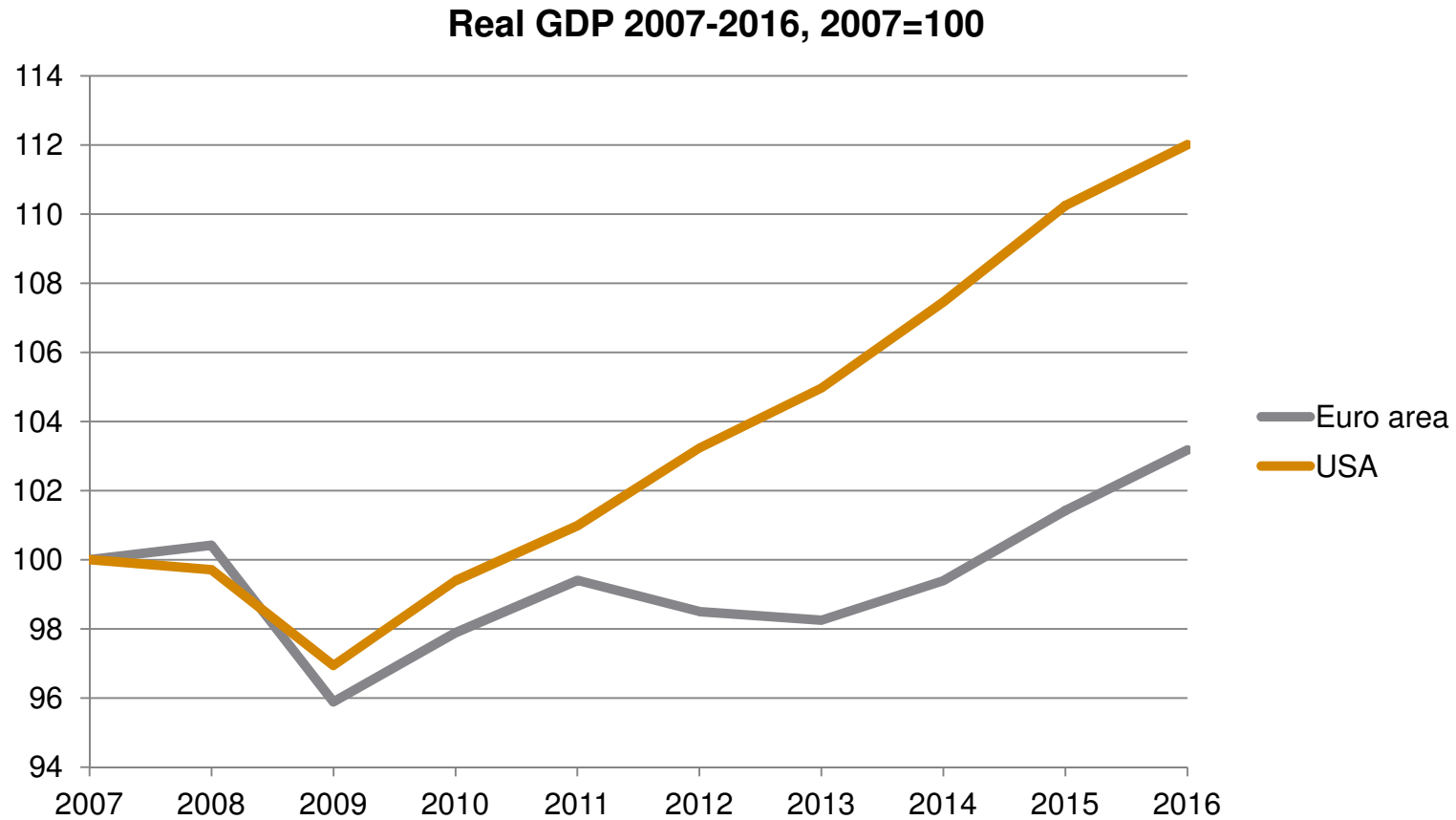
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Fiscal Consolidation and Disintegration Tendencies in Europe: Is there a Link?

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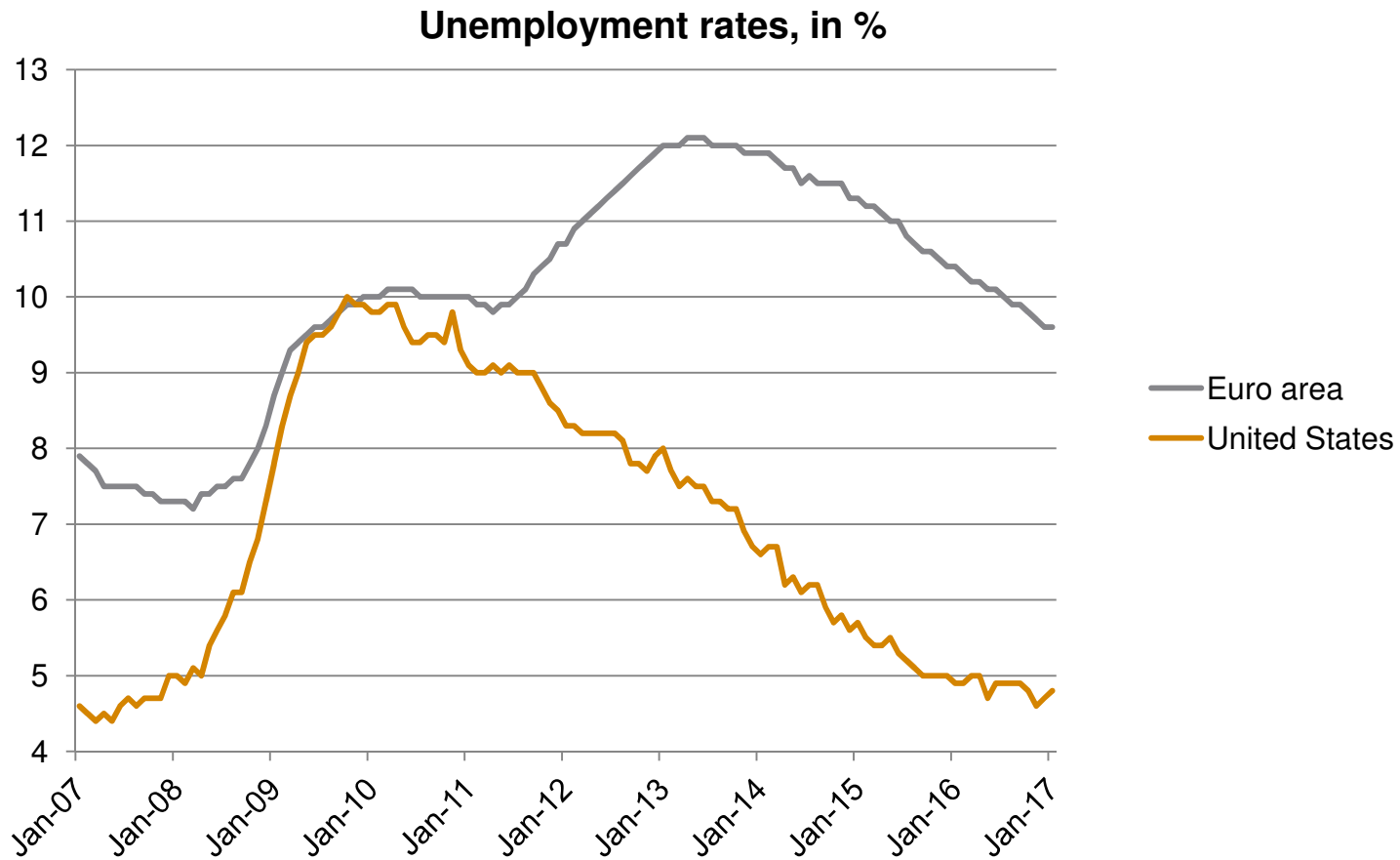
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Motivation: The underperforming euro area economy



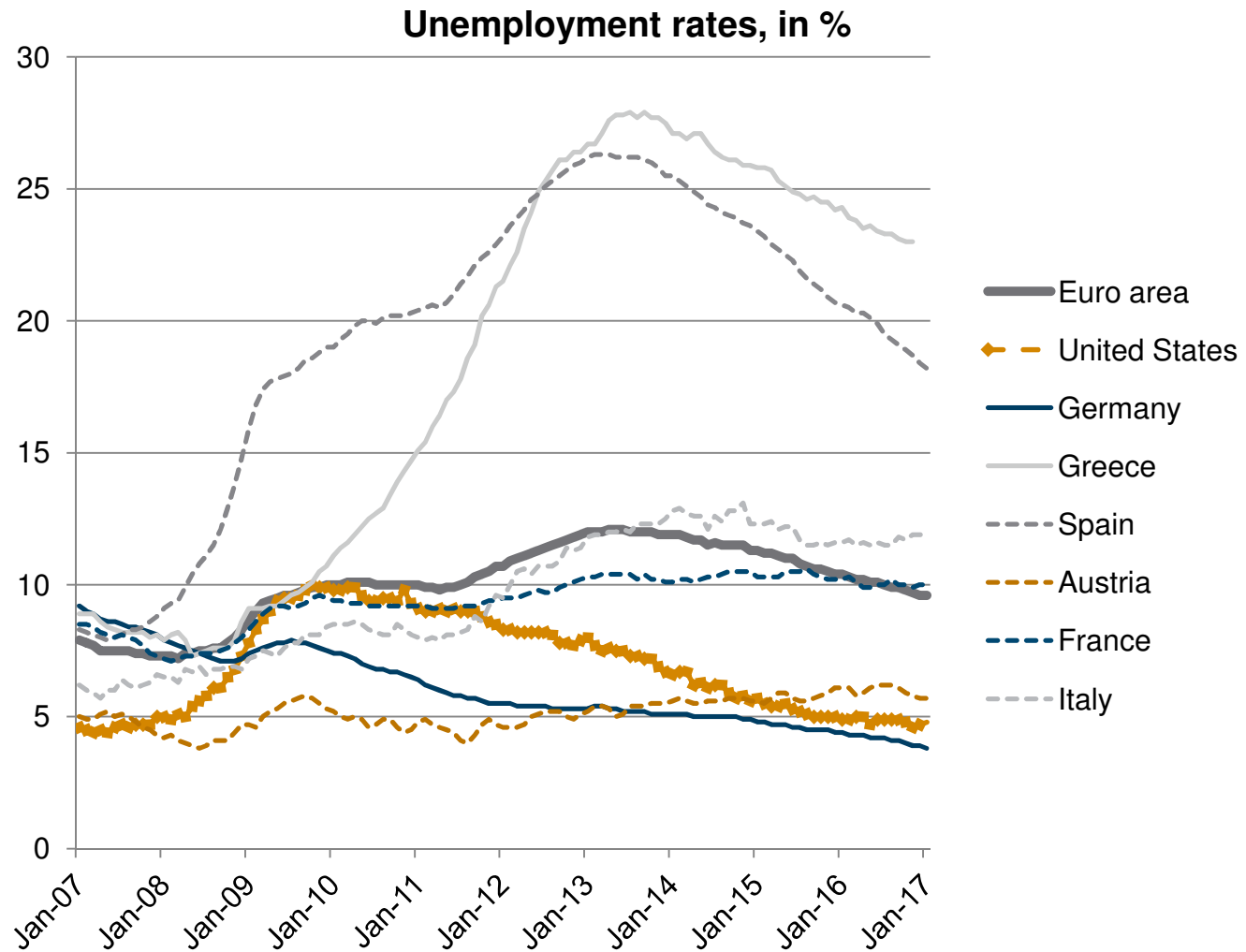
Source: AMECO (November 2016); own calculations.

Unemployment in euro area still above pre-crisis-level



Source: Eurostat.

Large divergences in unemployment within the euro area



Source: Eurostat.

The role of fiscal policy during the Euro Crisis: What have we learned?

- Fiscal multipliers
 - Growth effects
- Other macro effects of fiscal consolidation
 - Public debt sustainability
 - Income distribution
- European integration
 - ‘Structural unemployment’
 - GDP per capita

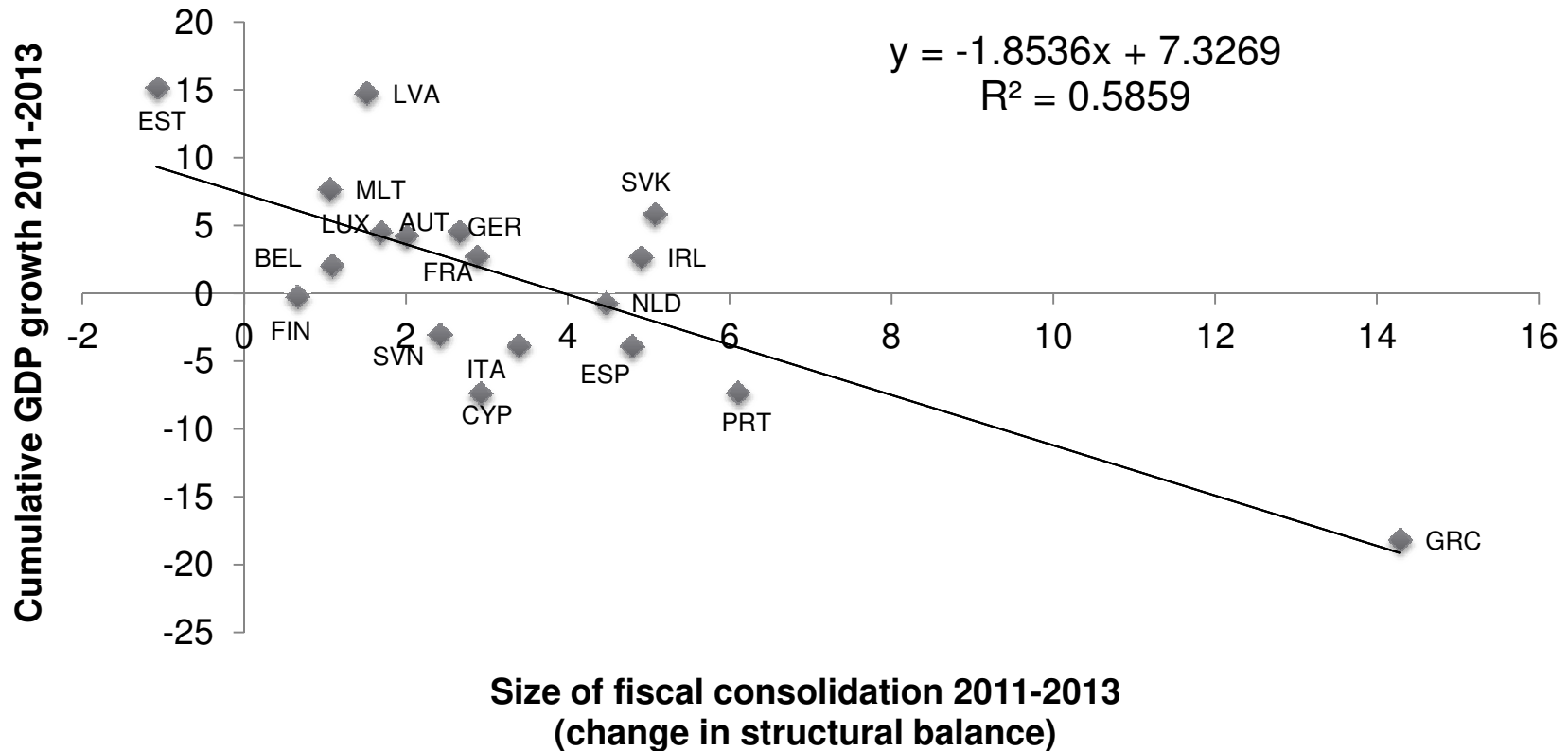
1. Fiscal multipliers

What are fiscal multipliers about?

- measure the short-term impact of discretionary fiscal policy on output
- An example
 - (exogenous) cut in government spending by €1 leads to fall in output by €1.2 → multiplier of 1.2
- determine fiscal adjustment costs in terms of economic activity: the higher the multiplier, the costlier the fiscal adjustment will be in terms of output losses

Multipliers were most probably higher than 1.0

**Fiscal consolidation and economic performance in the euro area
2011-2013**



Relationship holds when you exclude Greece!

Source: IMF (World Economic Outlook); own calculations.

Multipliers were most probably higher than 1.0

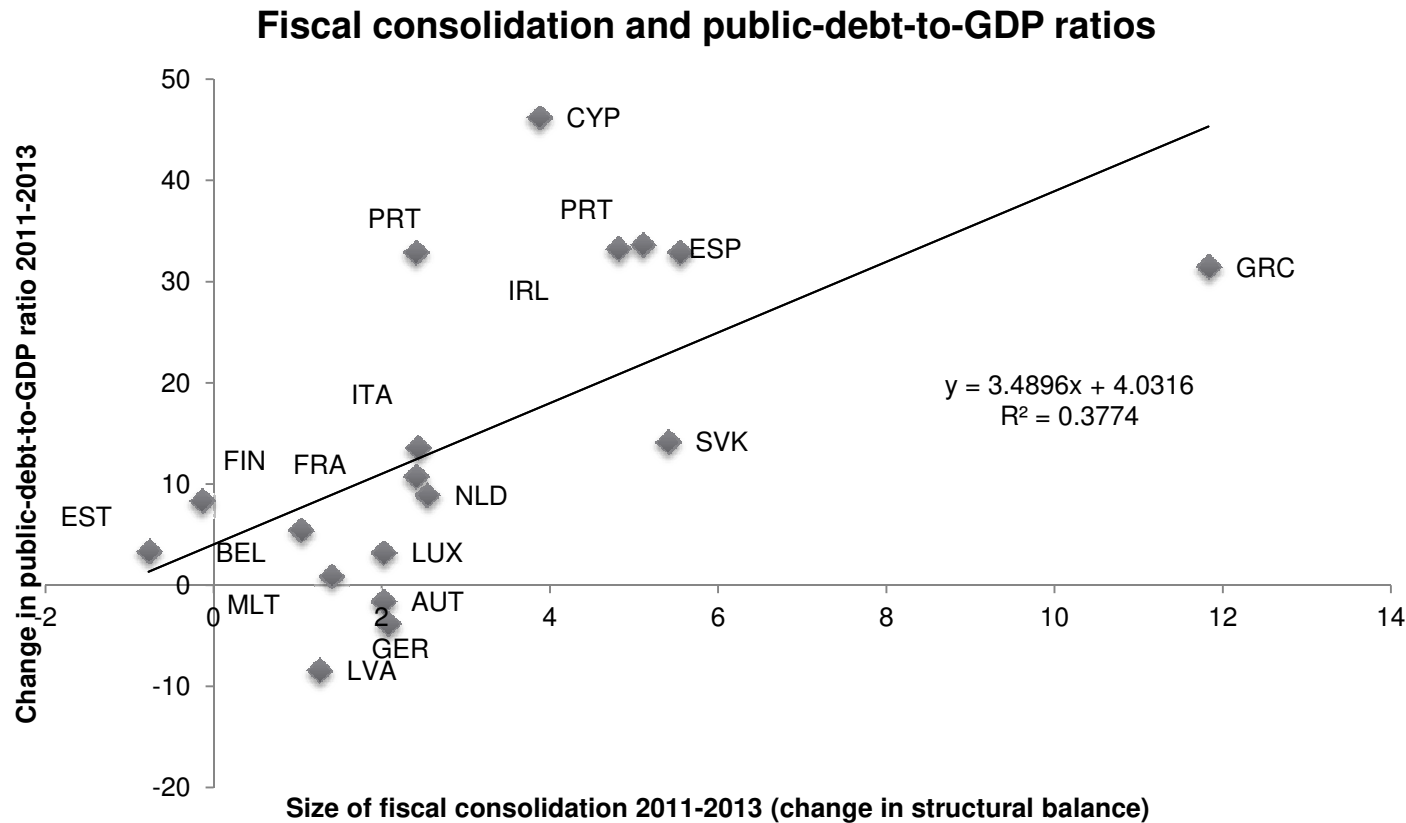
- There is not one multiplier for all countries and all times
- Multiplier higher than 1.0 when:
 - Economy is underutilised (e.g. DeLong, Summers, 2012; Jorda, Taylor, 2016)
 - Monetary policy is constrained by the Zero Lower Bound (e.g. Woodford, 2011)
 - The private sector is in deleveraging mode (e.g. Eggertsson, Krugman, 2012; Koo, 2015)
- Major conditions for multipliers higher than 1.0 were fulfilled in the euro area (during the period of the double-dip recession of 2011-2013)

Estimates indicate substantial cumulative output losses from fiscal consolidation measures in the euro area

	<i>2011</i>	<i>2012</i>	2013
European Commission (2012), pp. 45-46	---	0.3 / 0.9	0.5 / 1.6
Rannenberg et al. (2015), p. 21	---	---	5.2
In't Veld (2013), p. 10*	0.7	2.0	3.2
Holland and Portes (2012), p. F8	0.5 / 1.5	1.0 / 3.1	1.7 / 4.0
Gechert et al. (2015), p. 6	4.3	6.4	7.7
Heimberger (2017a)	---	---	5.5-8.4

2. Other macro effects of fiscal consolidation

As a consequence of the persistent crisis, debt sustainability has deteriorated further (in the periphery)

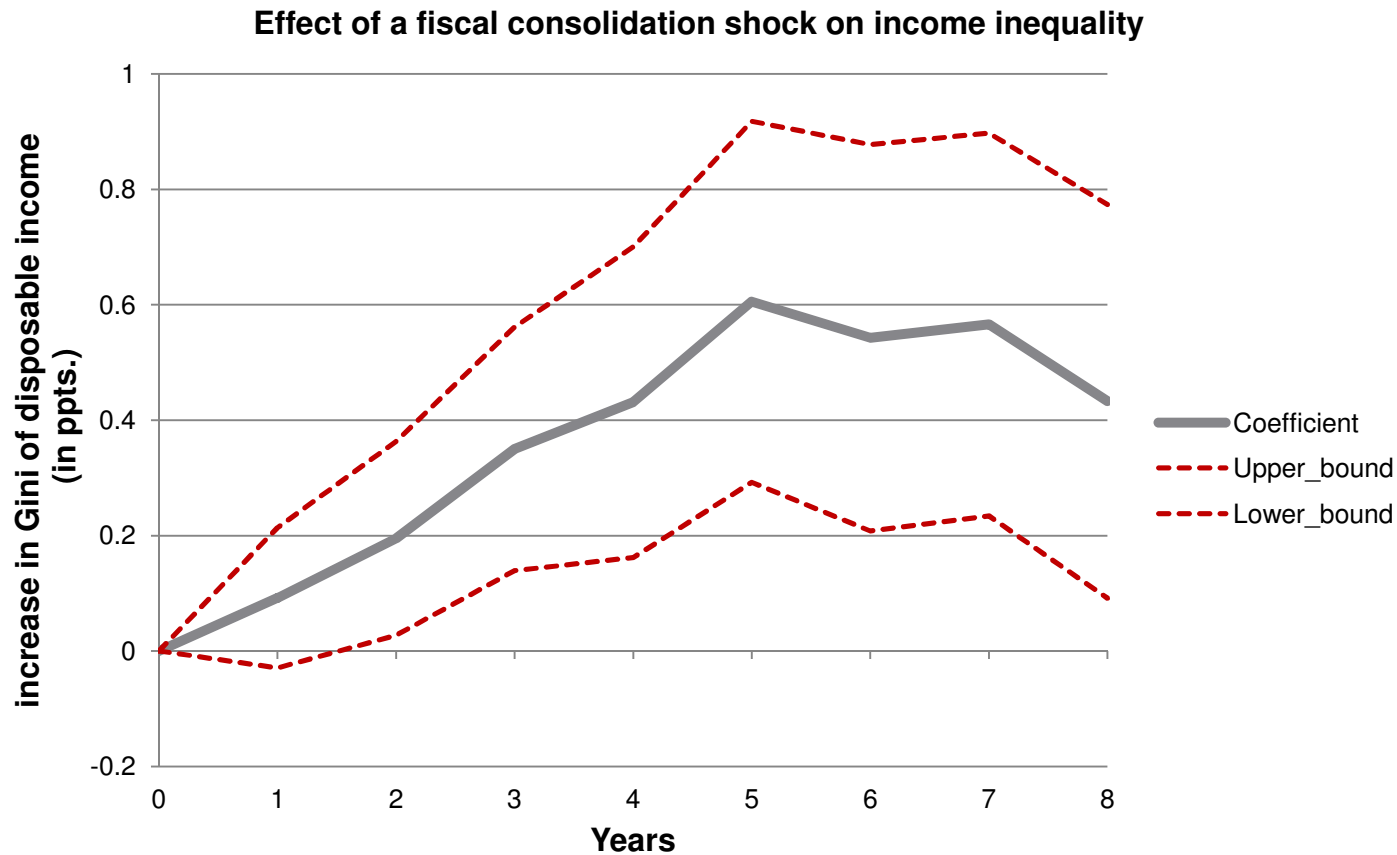


Fiscal consolidation may not only have growth and employment effects, but also distributional effects

- Potential (long-term) costs of fiscal consolidation
 - A. Income distribution and poverty
 - B. Physical infrastructure
 - C. Human capital

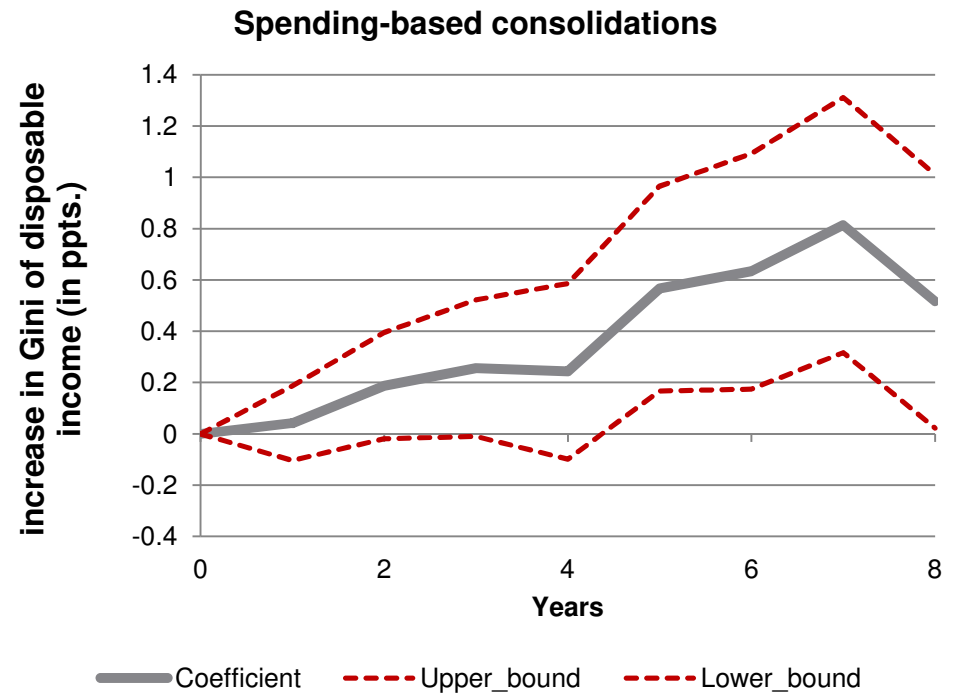
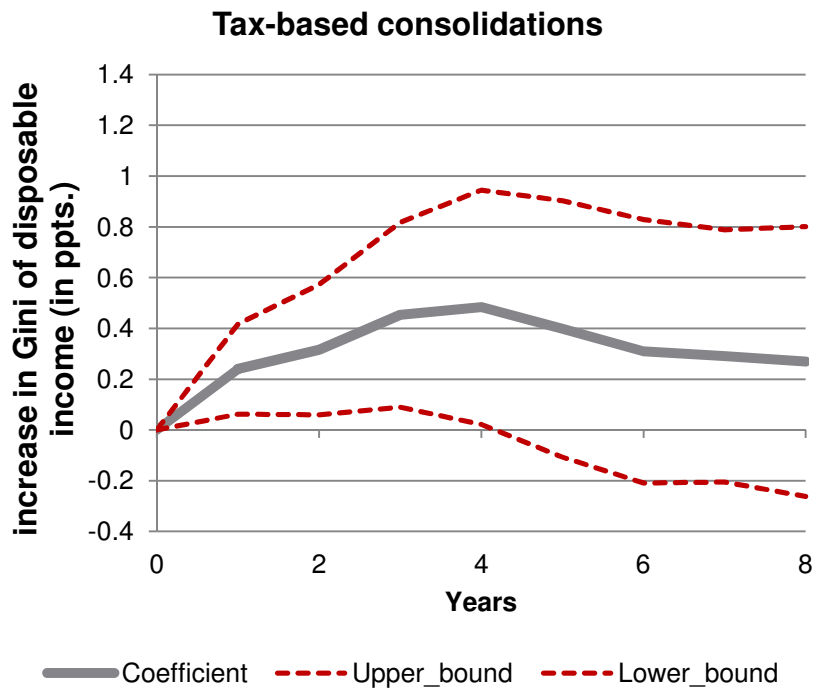
- Some empirical evidence on A) income distribution
 - Effects of fiscal consolidation episodes on income inequality
 - Gini coefficient of (disposable) income
 - 17 OECD countries (13 European, 4 non-European)
 - Time period 1978-2013
 - 'average response to fiscal consolidation shock'

Fiscal consolidation pushes up income inequality over the medium term



Source: Heimberger (2017b).

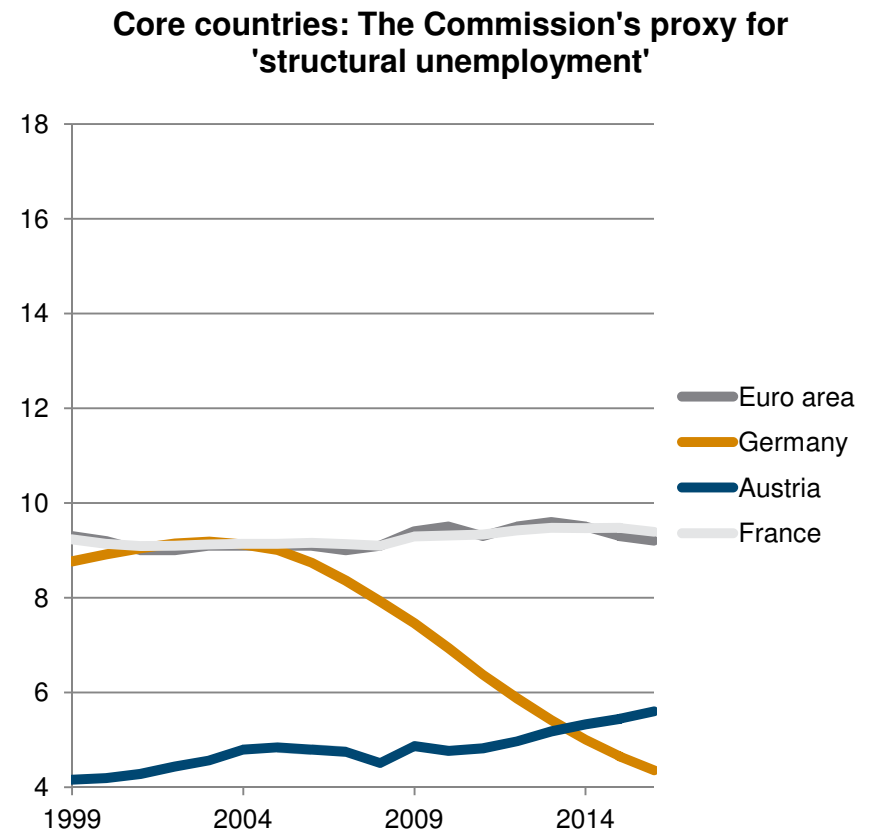
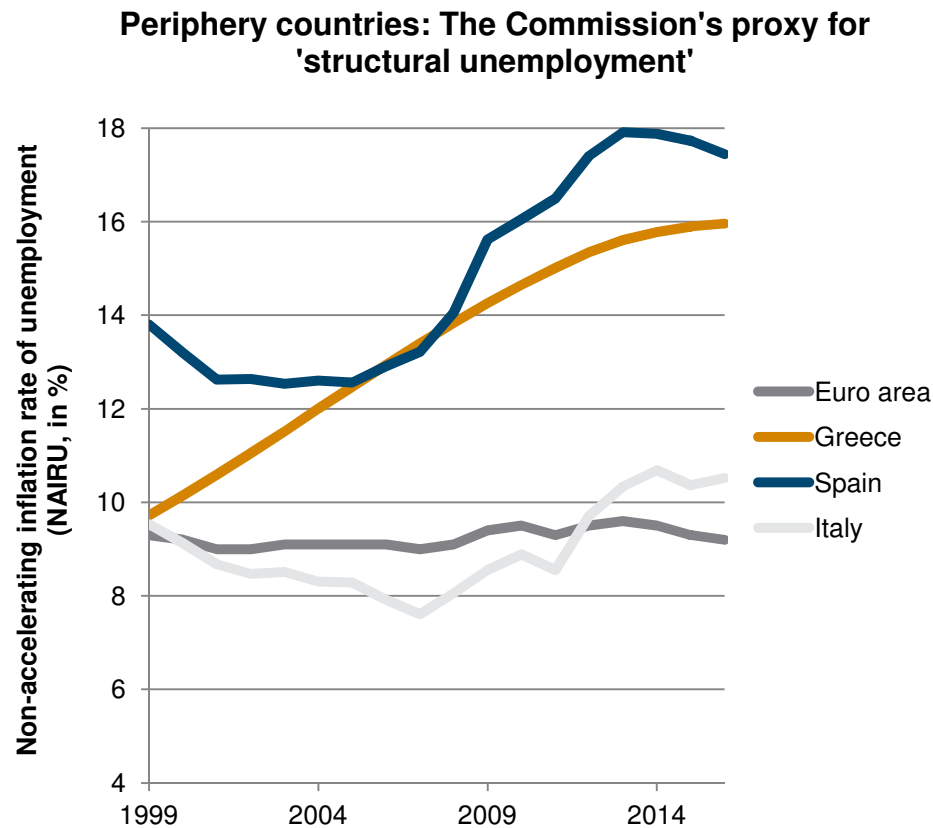
Distributional effects are more pronounced for government spending cuts than for tax increases



Source: Heimberger (2017b).

3. European integration

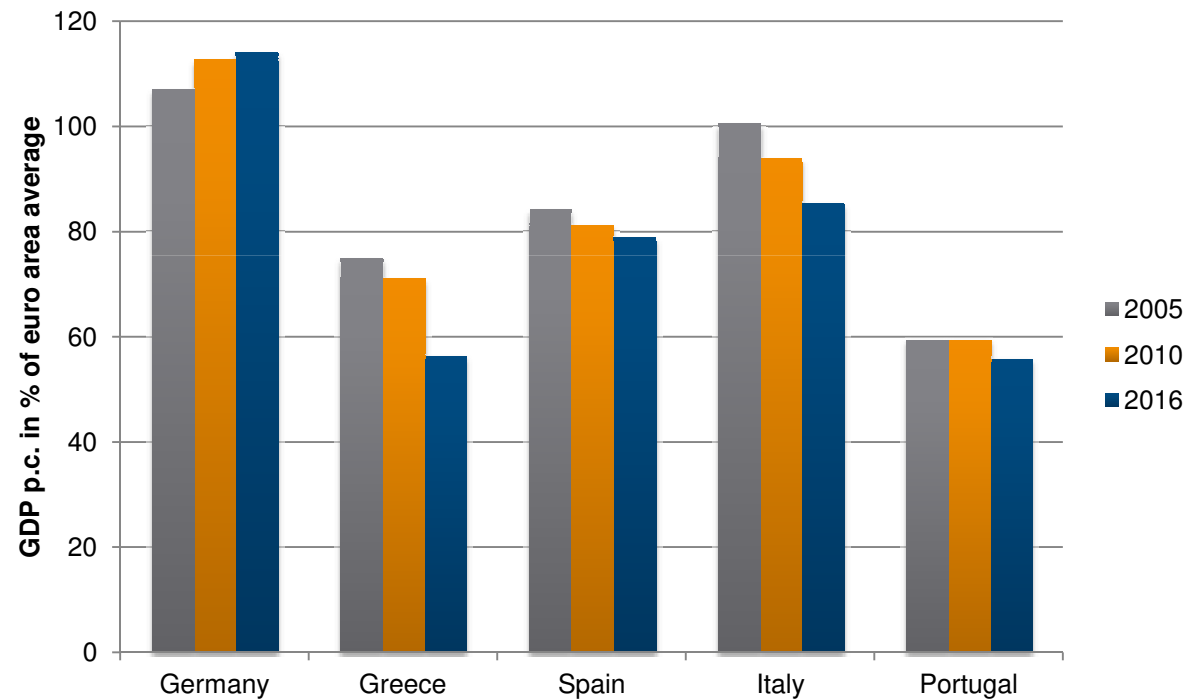
Has fiscal consolidation fuelled an increase in structural polarisation within Europe?



Source: AMECO.

Income polarisation: Southern Europe falling behind

GDP per capita (in % of euro area average)



Source: AMECO; own calculations.

Conclusions: Fiscal consolidation as a major contributing factor to disintegration tendencies in Europe

Consolidation-induced economic slump

→ political tensions

→ increased institutional distress

→ surge in populism

- Current situation is in some ways similar to the 1930s
- The persistent slump is certainly not the single cause of the rise in populism, but a major contributing factor in several European countries.

Some final thoughts on policy-making

- Major rethinking of existing economic policy paradigms could be especially fruitful in three areas
 - Economic growth and unemployment
 - More active role for fiscal policy to support the recovery and to curb macro imbalances
 - Income inequality
 - Higher weights for distributional aspects in fiscal policy decisions
 - Structural polarisation
 - Industrial policy to support structurally disadvantaged countries



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