

INSTITUTIONAL REFORMS TO ACHIEVE BALANCED GROWTH & CONVERGENCE IN THE EURO AREA

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International Economic Studies, WIIW
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Overview

Part I: Intra-EMU imbalances: demand and wages

- Do national current accounts matter in an unfinished monetary union?
- Is a focus on wages/unit labour costs justified?

Part II: EMU economic governance and reform needs

- Key failings of current economic governance architecture
- Reform proposals

Note: Draws on joint work „in progress“ with Willi Koll

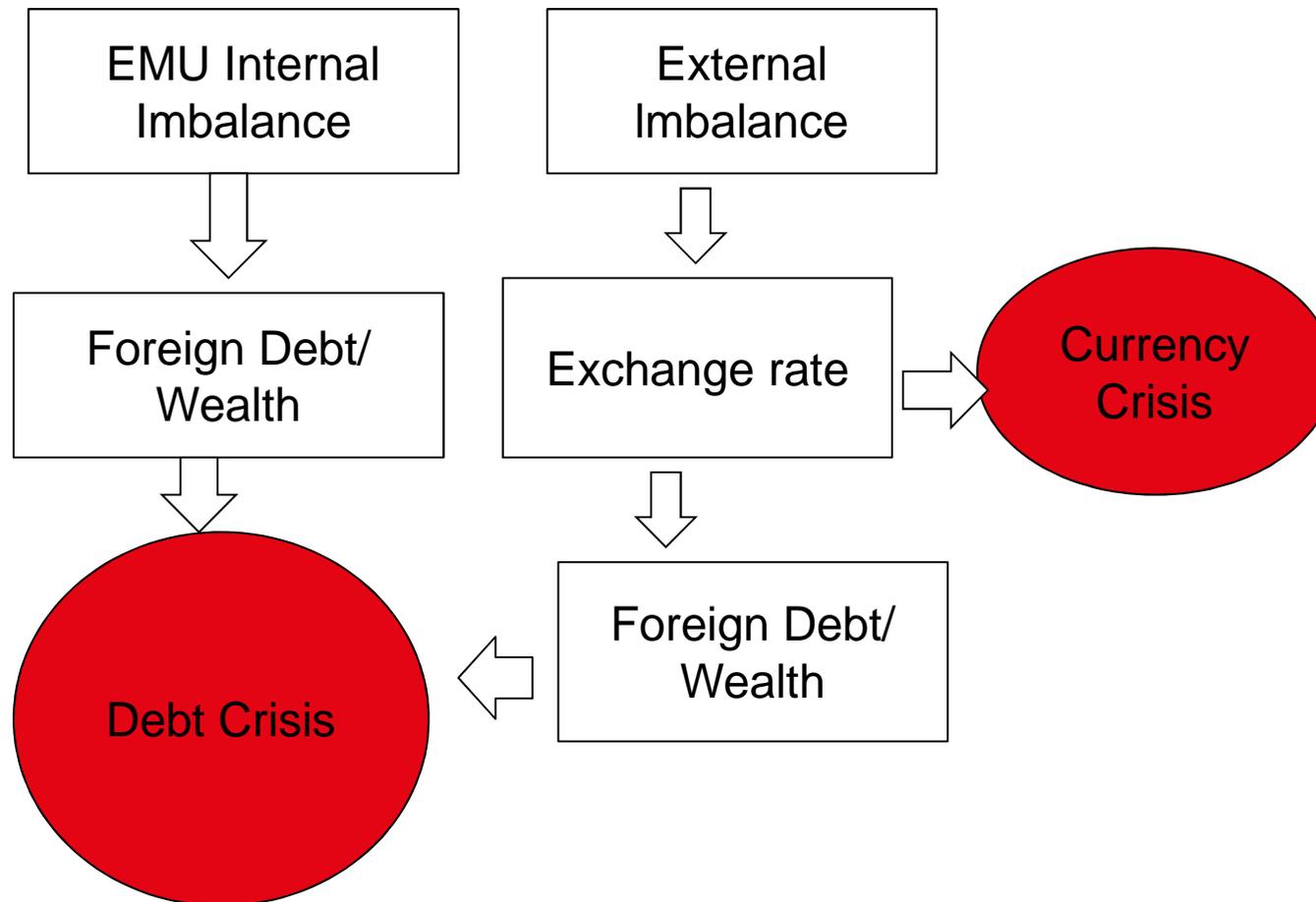
Part I: Intra-EMU imbalances: demand and wages

- Do national current accounts matter in an unfinished monetary union?
- Is a focus on wages/unit labour costs justified?

Summary of problem analysis

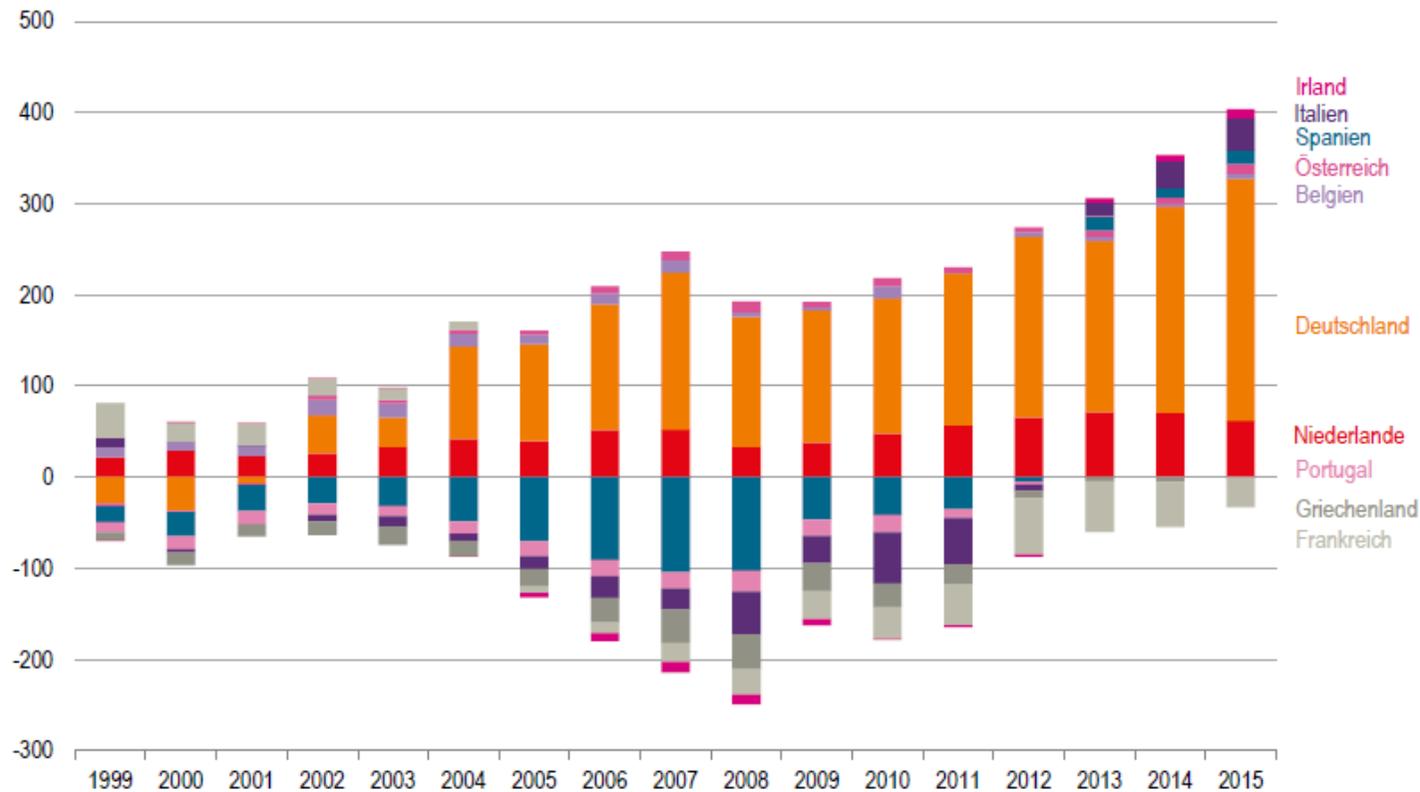
- Current account imbalances within €A – given its institutional limitations – at heart of the crisis
- Clear correlation between development of prices, nominal unit labour costs and C/A positions
- Since crisis: once-sided adjustment -> deflation, growing €A C/A surplus
- But causal links complex and disputed
 - Were wages driver or driven? Common 3rd factor?
- Capacity of national (nominal) wage „policy“ to counteract strong pro-cyclical tendencies limited
 - Real interest > real exchange rate channel
 - Capacity varies between MS depending on collective bargaining system
 - CB systems have been systematically weakened

Intra-EMU current account imbalances are not harmless?



Widening current account imbalances, one-sided correction

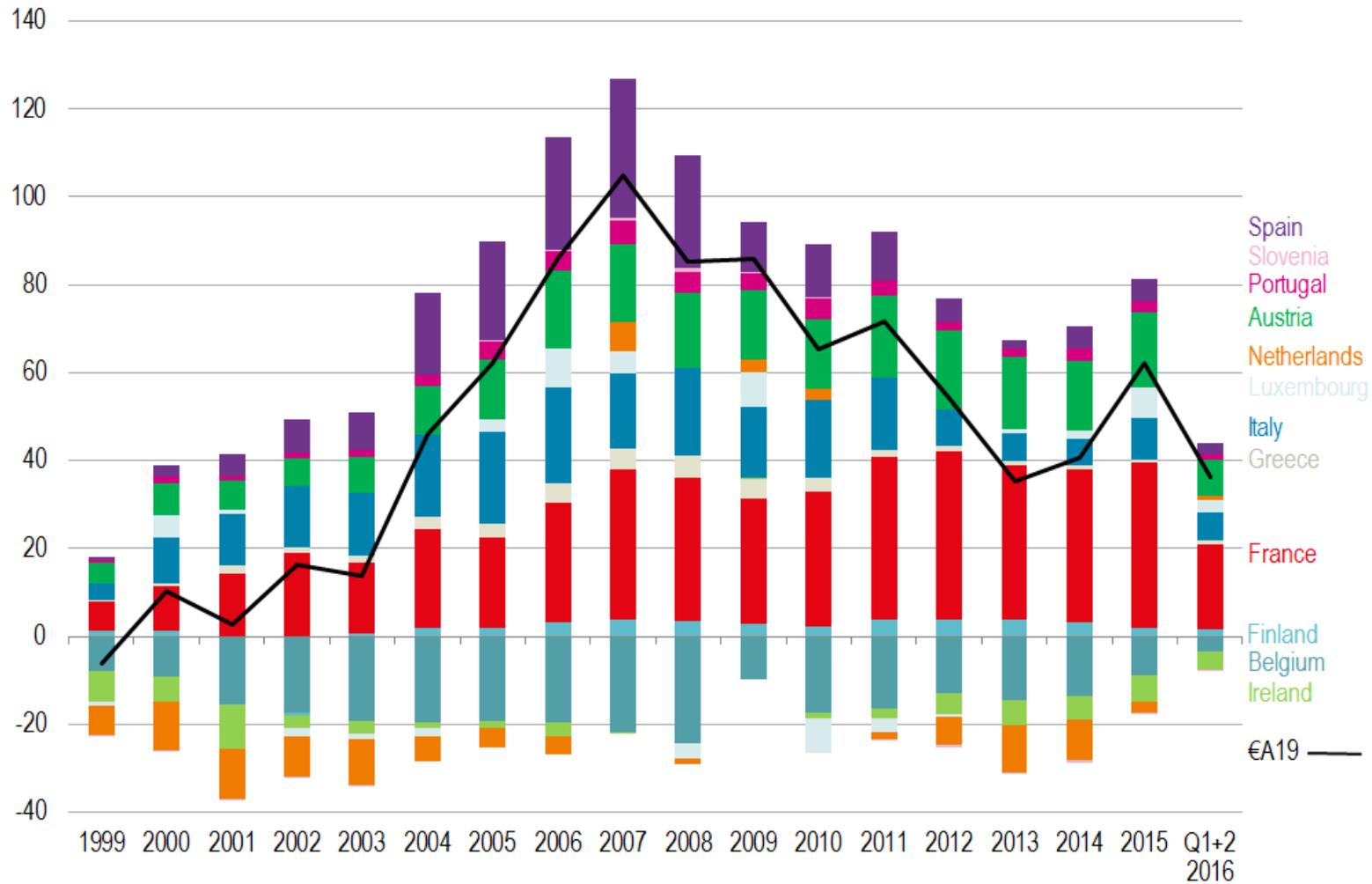
Leistungsbilanzsalden der Länder im Euroraum
in Mrd. EUR



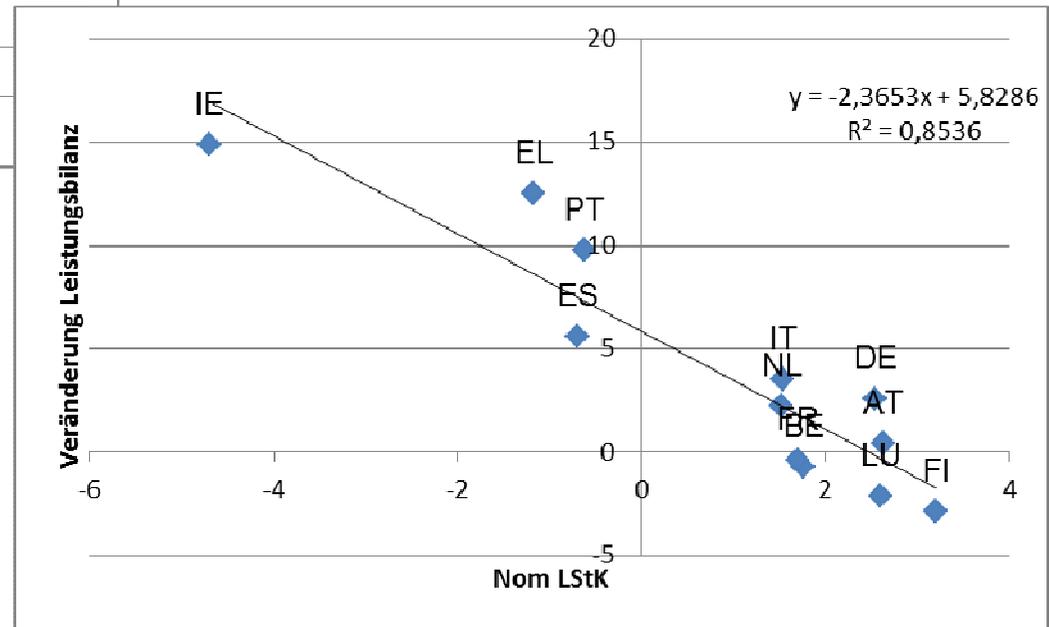
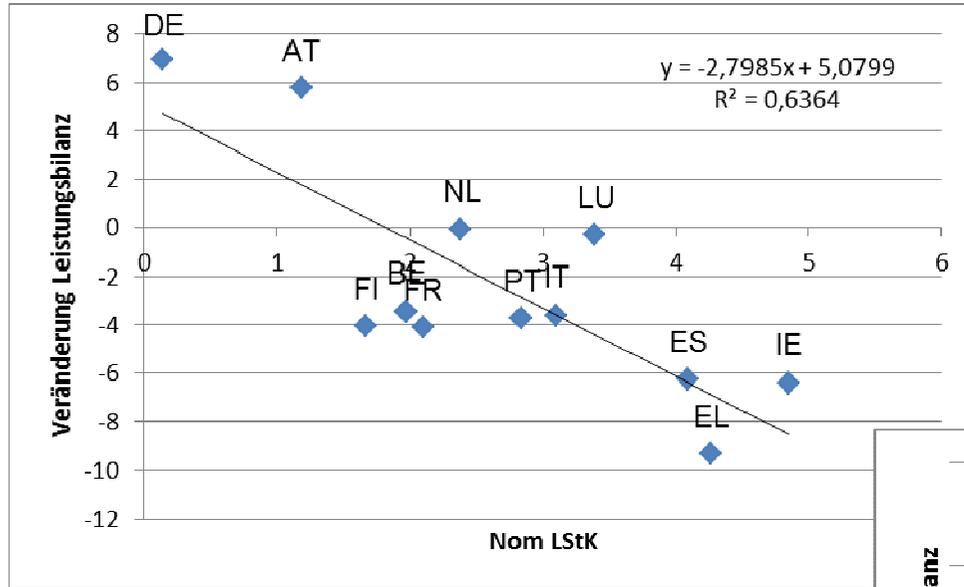
Quellen: Macrobond (AMECO); Berechnungen des IMK (Datenstand 10.05.2016).

Germany bilateral current account Imbalances

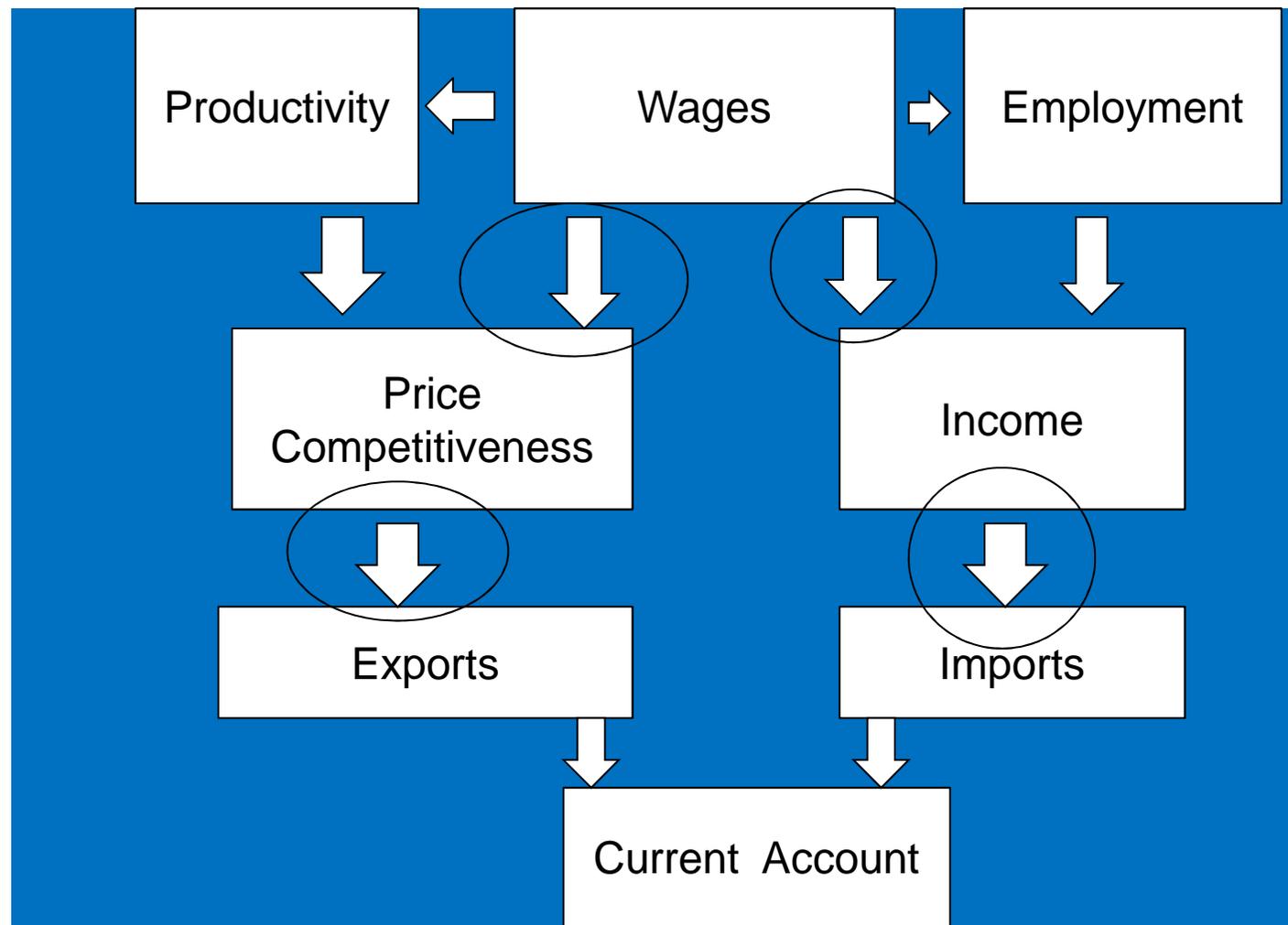
Billions EUR



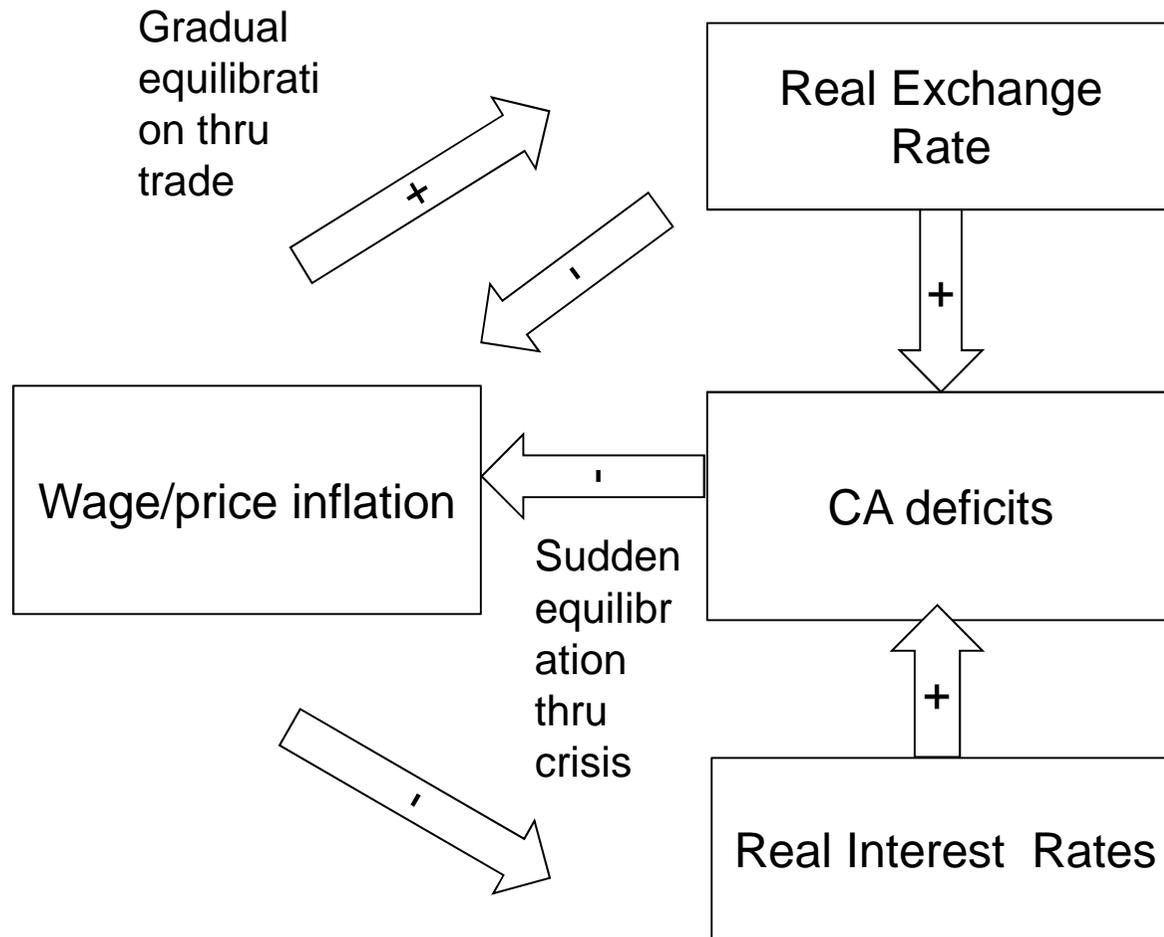
Change in ULC & CA 2000-08 and 2009-15



Simplified wage-current account linkages



Imbalances initially not self-correcting, until crisis



Role for wages/ULC in addressing imbalances? I

Key arguments

1. Wage rules are applied one-sidedly (as illustrated by the MIP)
 - True and applies to almost all variables in MIP
2. It's not just wages, it's profits (or: no 1:1 pass through wages-prices - table)
 - Yes, altho shift in labour share not permanent
3. Nominal wages and prices endogenously driven
 - Yes, vital to manage domestic demand
 - Wage policy cannot offset wrong macroeconomic policy
 - But nominal wage not a market plaything (otherwise why TUs, minimum wages etc.)

Inflation breakdown into wages, profits, taxes

Inflationszerlegung in ausgewählten Ländern

	Prozentpunkte 1999-2007							
	<i>BIP-Deflator, IST</i>				<i>BIP-Deflator, SOLL</i>			
	Gesamt	Lohn- Beitrag	Gewinn- Beitrag	Steuer- Beitrag	Gesamt	Lohn- Beitrag	Gewinn- Beitrag	Steuer- Beitrag
Deutschland	7,4	-0,6	6,1	1,9	18,0	9,2	7,1	1,6
Irland	33,1	12,5	15,9	4,7	17,8	6,9	9,0	1,9
Griechenland	27,7	12,8	10,7	4,2	18,0	5,8	10,3	1,9
Spanien	33,4	16,0	13,3	4,2	18,0	8,7	7,6	1,8
Italien	21,9	9,2	10,1	2,6	18,0	6,8	9,0	2,3
Portugal	30,1	12,8	12,3	5,0	18,0	8,6	7,2	2,2

	Prozentpunkte 2008-2015							
	<i>BIP-Deflator, IST</i>				<i>BIP-Deflator, SOLL</i>			
	Gesamt	Lohn- Beitrag	Gewinn- Beitrag	Steuer- Beitrag	Gesamt	Lohn- Beitrag	Gewinn- Beitrag	Steuer- Beitrag
Deutschland	11,8	9,2	1,2	1,4	16,0	8,0	6,5	1,6
Irland	-0,4	-6,9	9,0	-2,5	16,0	6,4	8,0	1,5
Griechenland	2,6	0,9	-0,1	1,9	16,0	5,5	8,7	1,8
Spanien	3,4	0,5	2,3	0,6	16,0	7,8	6,8	1,4
Italien	10,4	5,6	3,1	1,7	16,0	6,3	7,6	2,0
Portugal	8,0	0,6	6,1	1,3	16,0	7,4	6,7	1,9

Anmerkung: Die BIP-Inflationszerlegung in die drei inländischen Komponenten erfolgt jährlich. Hier werden die betrachteten Jahre aufaddiert. Damit ergibt sich eine Diskrepanz zur richtigen Wachstumsrate über die betrachteten Zeiträume.

Role for wages/ULC in addressing imbalances? II

A number of unconvincing counter arguments:

Non-price competitiveness

The fact that products are qualitatively different does NOT mean they do not compete on price

Price inelasticity argument

Doesnt apply to all goods/services, weak in the long run (firms leave money on table?)

CA not about relative prices, rather about demand

Yes demand crucial, but not separate from wage/price path (real interest rate)

No bilateral competition on product market

Strong indirect effects (third country, exchange rate)

Role for wages/ULC in addressing imbalances? III

IMK simulations for Germany 2001-2015 (forthcoming IMK Report. NB: entire DE CA)):

+1% wage increase at start of period: -€1,2/0.2 bn

„Macroeconomic wage policy“ (2.65%p.a.): -€16.4bn

Macro wage policy plus fiscal recycling: -€34.2 bn

Weak effects: real changes larger than nominal (price inelasticity), high import content of exports)

-> additional wage boost (now) needed, expansionary fiscal policy, and symmetrical policies in other €A MS

Simulation results (forthcoming IMK report)

	Wirkungen einer Lohnerhöhung um 1 %		Makroökonomische Lohnpolitik ¹	
	mit pricing to market (PTM)	ohne PTM	ohne Budgetneutralität	mit Budgetneutralität ²
			mit PTM	mit PTM
	Szenario 1	Szenario 2	Szenario 3	Szenario 4
Ergebnisse				
Bruttoinlandsprodukt, real	0,1	0,2	1,7	3,7
Beschäftigte	0,1	0,1	1,3	3
Bruttolöhne (pro Kopf)	1,0	1,0	14,5	14,5
Bruttogewinne insgesamt	-0,1	0,1	-1,0	8,5
Lohnquote ³	0,4	0,3	4,5	2,4
Lohnstückkosten	1,0	1,0	14,0	13,7
Preisindex privater Konsum	0,3	0,3	3,6	3,5
Preisindex der Exporte	0,5	0,3	6,3	6,2
Preisindex der Importe	0,3	0,0	3,7	3,7
Transfers an die privaten Haushalte	0,8	0,8	11,6	17,4
Privater Verbrauch, real	0,4	0,5	5,4	8,4
Staatsverbrauch, real	0,1	0,1	1,1	3,9
Bruttoanlageinvestitionen, real	0,1	0,1	0,7	3,1
der Öffentliche Investitionen, real			1,1	38,6
Exporte, real	-0,2	-0,2	-3,0	-2,9
Importe, real	0,1	0,2	1,4	2,8
Bruttoinlandsprodukt, nominal	0,6	0,7	8,7	11,1
Exporte, nominal	0,2	0,2	3,2	3,1
Importe, nominal	0,4	0,2	5,1	6,6
Staatsbehalten, nominal	0,8	0,8	11,4	14,2
Staatsausgaben, nominal	0,7	0,7	10,3	14,3
Zusammenfassung				
Finanzierungssaldo Staat (nominal, Abw. in Mrd. EUR, Überschuss: +)	1,1	1,7	17,6	3,2
Außenbeitrag (real, Abw. in Mrd. EUR)	-4,4	-4,4	-56,0	-72,1
Außenbeitrag (nominal, Abw. in Mrd. EUR)	-1,4	-0,2	-16,4	-35,2

Key policy-relevant conclusions regarding role of wages and demand

1. Price competitiveness and current account imbalances are important in EMU
2. Wages/ULC are an important (but not only) element of competitiveness
3. Wages (incomes policy) ONE tool amongst others
4. Overriding importance of countercyclical (= counter-imbalance) macroeconomic policies
5. Profit inflation needs to be considered
6. Incomes policy institutionally demanding
7. Symmetry of approach (wage norm, balanced current account) vital
8. Social partners (SP) need seats at the

Part II: EMU economic governance and reform needs

- Key failings of current economic governance architecture
- Reform proposals

Economic governance architecture

Complex, confusing, dysfunctional set of overlapping institutions, processes, targets, rules and guidelines

- Europe2020 Strategy
- Broad Economic Policy Guidelines
- Euro Plus Pact
- Stability and Growth Pact
 - Fiscal surveillance recently extended by Six and Two pack and (intergovernmental) Fiscal Compact
- Macroeconomic Imbalance Procedure (MIP)
- (All supposedly coordinated in European Semester)
- Macroeconomic Dialogue (MED) – almost unknown

Governance developments since the crisis

- Tightening of fiscal rules that (even if couched in „structural“ terms) remain focussed on narrow public finance goals irrespective of C/A, rel.competitiveness
 - Still limited pressure to save in good times
- Macroeconomic Imbalance Procedure (MIP)
 - good in principle addresses key issue, broad indicator set, multi-stage process, „under shadow“ of ultimate sanctions
 - But flawed in practice (asymmetry, question of addressee, unclear implications for SP autonomy, fiscal overlap)
 - No attempt to tie in to or strengthen/deepen existing Macroeconomic Dialogue (MED)

Five Presidents' Report

- Attempt to sketch out path to needed deepening of EMU
- Focus here on competitiveness authorities & advisory fiscal council
 - Fundamental mix-up/misunderstanding btwn need for all MS to improve their competitiveness and issue of nominal intra-EMU divergence
 - Positive: no harmonisation of national systems, analytical/advisory role, €A-wide umbrella, overall fiscal stance
 - Problematic: Fixation with wages (profits?), non-incorporation of fiscal policy, presumption of asymmetry (tie-in MIP), reliance on „experts“ (social partners role?)

EU COM Recommendation 13 June 2016

- Now renamed „productivity councils“ – remit broadened (potential growth, investment)
- Conceptual mix-up/misunderstanding worse
 - „productivity“ can remain a national concern as it does not itself have spillovers
- Powers of councils reduced (in the face of opposition from social partners and especially unions);
 - largely analytical tool (no longer making recommendations)
 - risk to autonomy of bargaining reduced, but also steering capacity

Take a step back: requirements for an integrated economic policy framework

- Overcome disjunction between fiscal management and current account/imbbalances
- Incorporate monetary policy
- Determine appropriate aggregate stance and coherent national policy stances
- Bring together all concerned actors
- EU coordination and constraints on national policy where added value (spillovers)
- Strengthen institutional capacity at national level (weakened by institutional „reforms“)

First best solution – federalist push

- Along lines recommended by EP Committee on Constitutional Affairs (Verhofstadt report)
 - Economic policy a shared competence
 - EU finance minister in COM
 - Fiscal capacity, own resources, common debt issuance
 - Convergence code incorporating fiscal rules, MIP and country-specific recs, to set out mutually consistent behaviour
 - Legally binding sanctions (carrots rather than sticks)
- Unlikely to fly in near term, large-scale treaty reform
 - > need for a more piece-meal approach also to make visible progress quickly.
 - > adapt existing institutions where possible.

Recommendation for the governance framework: activate BEPGs

- Broad Economic Policy Guidelines (Art 121 TFEU)
 - Offer the right macroeconomic framework (including balanced nominal wage recommendation – golden rule)
 - Have only twice led to recommendation to a MS (IE 2001, EL 2010) and never to sanctions
 - Lack of clear criteria for sanctions and much less present in domestic policy debate than SGP
- Use the overarching framework as legal basis to guide EU-MS relations
- Draw on expertise & quantitative scenarios (boards)
- Council/COM issue quantitative BEPGs for policy mix (MP, FP, WP) in Annual Growth Survey
- SWP/MIP can be (initially) retained, but subordinate

Recommendation for expertise at €A level: broaden remit of fiscal council

- Establish an advisory council for macroeconomic convergence at euro area level
- Modelled institutionally on the Advisory Fiscal Council
- But with a remit for forward-looking, coherent encompassing macroeconomic policy analysis bringing in monetary, fiscal and incomes policy, of the €A as a whole
- Coordinates national convergence councils and develops quantitative development scenarios
- E(M)U-wide, symmetrical view, not race to the bottom
- Pluralist in terms of appointments

Recommendation for expertise at MS level: establish MS „convergence councils“

- Modelled institutionally on the proposed competitiveness/productivity councils
 - That means also analytical not advisory/decision-making role
- But here too with a clear focus on stable balanced development & upward convergence, not misleading/damaging „competitiveness“ or structural reform agenda
- Distributional issues
- Identify risks ex ante, set out policy options & trade offs.

Recommendation to get from analysis to policy: broaden and deepen MED I

- Macroeconomic Dialogue existing in the shadows since start of EMU
 - Biannual meetings at technical and political level
 - Weaknesses: exchange of information, EU, not EMU-focus, little articulation with national bodies
 - But the „right“ body in terms of remit (policy mix, balanced, employment-friendly, sustainable growth) and participation/ownership (central banks, fiscal policy, and social partners)
- Proposal: activate MED to support implementation of analytical recommendations
 - Establish a MEDeuro and link to Eurogroup
 - Establish MEDnats
 - Ensure articulation & support (secretariat)
 - Draw on analyses of convergence councils
 - Feed outcomes into BEPG-process

Recommendation to get from analysis to policy: broaden and deepen MED II

- Agenda: discussion of situation, identify policy needs and own and contribution of other actors
 - Evaluate the report of the convergence council for the euro area
 - Evaluate nominal wage developments against an extended golden rule (medium-run productivity + price target + CA imbalance correction)
 - Given that monetary policy ensures favourable monetary conditions
 - National fiscal policy contributes to symmetric stabilisation with counter-cyclical automatic and discretionary fiscal policy, where appropriate supported by national macroprudential policy
 - As appropriate take account of any cross-border stabilisation (EU UI – next slide, or common fiscal resources)
- Weight of incomes vs macro policy varies across MS

Recommendation: Cross-border automatic stabilisation

- Alongside the above pragmatic development of E(M)U institutions some form of automatic stabilisation across borders would be helpful (if not a necessary condition)
- A number of proposals on the table and currently subject to detailed analysis (COM White paper?)
- In particular a partial Europeanisation of unemployment insurance if technical and political issues can be overcome
 - Promote symmetrical nominal convergence
 - Improve aggregate outcomes, removing constraints facilitating monetary policy
 - Promote social cohesion and ideas of European solidarity and „demos“

Thank you for your Attention

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