Macro policy coordination in the euro area: impossible task?
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1. Fiscal policy
2. Non-fiscal policies
3. Implications of Brexit
1. Fiscal policy: 3 major obstacles to coordination

1. **Intellectual: e.g. interpretation of the current account**
   - Country-by-country assessment on supply-demand imbalances is contrasted depending on whether it relies on output gaps or on current accounts.
   - Is a large CA surplus a good thing? No common view

2. **Process: mostly bottom-up**
   - Despite recent progress, budgetary plans assessed based on national plans and on SGP rules at national level
   - Suggestion: a short note on the “desirable” aggregate fiscal stance for t+1 just after Spring t forecasts are released (with possible involvement of the EFB). Objective binding in exceptional times when fiscal spillovers are important, not in normal times (subsidiarity)
3 obstacles to coordination (ctd)

3. **Instruments**: discretionary policy rarely counter-cyclical (fiscal stabilization mostly relies on *automatic stabilizers*)

- Automatic stabilization may involve deviations from SGP, at least in the corrective arm of the Pact
- € area instrument should be automatic: temporary transfers related to the output gap? 3 problems
  a) Measurement of the output gap
  b) No permanent transfer: ex ante or ex post?
  c) No stabilization if transfer is saved → targeted transfers in order to maximize the multiplier + be visible to the citizen
Contributions to euro area’s gap
(in percent of euro area’s potential GDP)

Source: Ameco.
Contributions in €area current accounts
(percent of euro area’s GDP)

Source: Ameco.
Objecting to the current account

1. Competitiveness

Source: Ameco.
Objecting to the current account

2. Ageing

Source: Ameco.
Objecting to the current account

3. Terms of trade

Source: Ameco. Terms of trade are the average over Germany, France, Italy and Spain.
How to implement an aggregate fiscal stance?

Two possibilities:

1. The current one: coordination

2. Or shift to a more standard organization:
   - No bail-out
   - Subsidiarity
   - Federal budget

The debate is sometimes too naive.:
   - Zero bail-out will not happen, see existing federations (cf. Cottarelli et al. 2012)
   - Stabilization does not necessitate a large budget.
   c.f. US federation layer to unemployment benefit system: re-insurance, length extended from 26 weeks up to 99 weeks, 0.5% of GDP in 2009, annual cost=42 $/worker.
An alternative to fiscal coordination
(a possible trinity)

Responsibility:
credible no bail-out

Bank de-nationalisation, “safe” bonds

Re-nationalisation of fiscal rules

Common borrowing capacity

Subsidiarity: national sovereignty on national fiscal policy

Stabilization/Solidarity: targeted, temporary automatic transfers
2. Non-fiscal policies

**Macroeconomic Imbalances Procedure** (European semester)

- Lack of consistency: (i) of indicators (scoreboard), (ii) on link between indicators and country classification, (iii) on link between classification and country-specific recommendations

- Overlap between MIP, SGP and Europe 2020 « integrated guidelines »:
  - Public debt central in MIP \(\rightarrow\) duplicates the SGP
  - Same reform can appear under MIP or Europe 2020 heading
The Macro-imbalance procedure (MIP)

Scoreboard: 14 headline indicators + 25 auxiliary indicators

Alert Mechanism Report (Nov t-1)

No imbalances

In-depth review (March t)

Imbalances

Excessive imbalances

Excessive imbalances with corrective action

Corrective action plan

Sanctions (0.1% of GDP)

Country-specific recommendations (May t)
Scoreboard headline indicators

- 3 year backward moving average of the current account balance as percent of GDP, with thresholds of +6% and -4%;
- net international investment position as percent of GDP, with a threshold of -35%;
- 5 years percentage change of export market shares measured in values, with a threshold of -6%;
- 3 years percentage change in nominal unit labour cost, with thresholds of +9% for euro area countries and +12% for non-euro area countries;
- 3 years percentage change of the real effective exchange rates based on HICP/CPI deflators, relative to 41 other industrial countries, with thresholds of -/+5% for euro area countries and -/+11% for non-euro area countries;
- private sector debt (consolidated) in % of GDP with a threshold of 133%;
- private sector credit flow in % of GDP with a threshold of 14%;
- year-on-year changes in house prices relative to a Eurostat consumption deflator, with a threshold of 6%;
- general government sector debt in % of GDP with a threshold of 60%;
- 3-year backward moving average of unemployment rate, with a threshold of 10%;
- year-on-year changes in total financial sector liabilities, with a threshold of 16.5%;
- 3 years change in p.p. of the activity rate, with a threshold of -0.2%;
- 3 year change in p.p. of the long-term unemployment rate, with a threshold of +0.5%;
- 3 year change in p.p. of the youth unemployment rate, with a threshold of +2%.
Public and/or private debt?

Public and private debt, 2015 scoreboard, % of GDP

Source: 2015 scoreboard. Dotted line: 193% threshold
Competitiveness?
Change in export market share over 5 years (percent)

Source: 2015 scoreboard. Dotted line: -6% threshold.
Unemployment!
Three-year average unemployment rate, % of labour force

Source: 2015 scoreboard. Dotted line: 10% threshold.
But no clear transcription in CSRs

Number of CSRs per policy area in 2015

Source: European Parliament, “Country Specific Recommendations for 2014 and 2015: A comparison and an overview of implementation”, 25 August 2015, and own calculations. Fiscal and tax includes pensions and social security contributions. “Other” includes deregulation of markets, investment, R&D, justice, housing, governance. When a recommendation belongs to two different areas, it is counted as 0.5 in each of them.
CSRs cover SGP, MIP and 2020 “integrated guidelines”

Number of CSRs of each category in 2015

Overlaps

SGP

MIP

2020

- Confusion
- Lack of ownership
- Lack of time frame
**SGP**

**Objectives:** fiscal sustainability & stabilization  
**Instrument:** govt budget  
**Horizon:** short and medium term, yearly review  
**Flag:** govt balance

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**Objective:** growth (GDP and employment)  
**Instruments:** structural  
**Horizon:** long term, multi-year review  
**Flags:** LT growth, employment rate

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**MIP**

**Objective:** financial sustainability  
**Instruments:** macro-pru, taxation, etc.  
**Horizon:** medium term, yearly review  
**Flag:** current account

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**Clarification needed**
3. Implications of Brexit

Political message:
• Social inclusion is key; realities or perceptions (or both). Problem: most instruments are in national hands (urban segregation, school drop outs, housing,…)
  → Protect national tax bases, fight international fraud (e.g. displaced workers)
• Trade-off between efficiency and equity must be openly debated, transition is important. Ex. TTIP.
• Europe must be visible not only for the bad. Ex. Erasmus

Too much or too little?
Economic union, monetary union, banking union, capital market union: too much or too little? Fiscal union?
→ Do not rush on fiscal union: fiscal union should accompany banking union, capital market union,… job union
# Tentative time frame

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<thead>
<tr>
<th>Short term</th>
<th>Medium term</th>
<th>Longer term</th>
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<tbody>
<tr>
<td>1. NPLs// bail-in rules → common fiscal backstop</td>
<td>1. Bank de-nationalization → asset divers., EDIS</td>
<td>1. Capital market union → legal convergence</td>
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<td>3. Econ. governance → simplification</td>
<td>3. Fiscal capacity</td>
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No treaty change, but ideological convergence needed
References


• “Economic policy coordination in the euro area under the European Semester”, Report for the European Parliament (ECON), PE 542.676, November 2015.

• “Which fiscal union for the euro area?”, Note of the Conseil d’Analyse Economique No. 29, Feb. 2016, with X. Ragot and G. Wolff.