

# 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

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## 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**

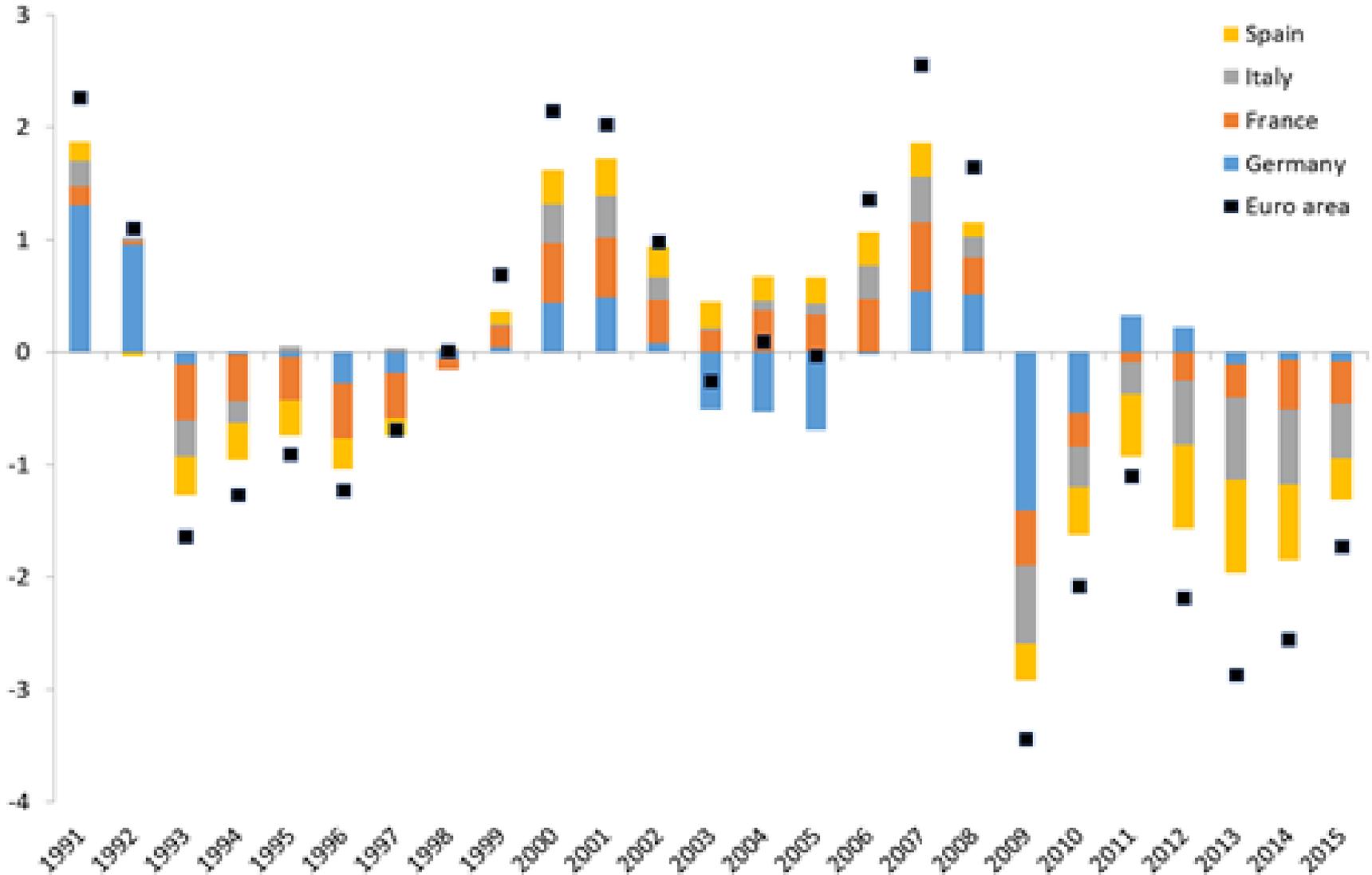
- Despite recent progress, budgetary plans assessed based on national plans and on SGP rules at national level
- Suggestion: a short note on the “desirable” aggregate fiscal stance for  $t+1$  just after Spring  $t$  forecasts are released (with possible involvement of the EFB). Objective binding in 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

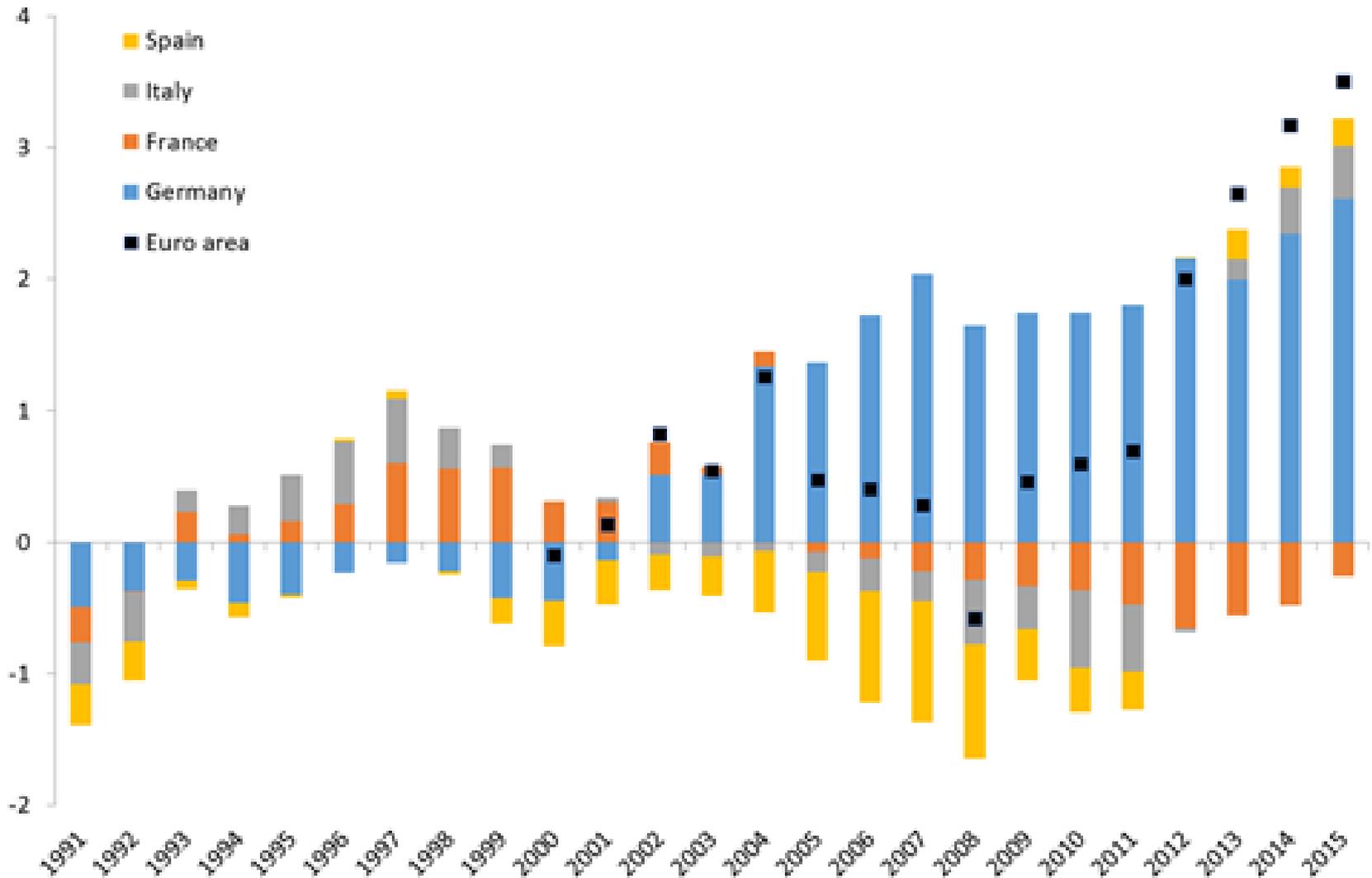
# Contributions to €area's gap

(in percent of euro area's potential GDP)



Source: Ameco.

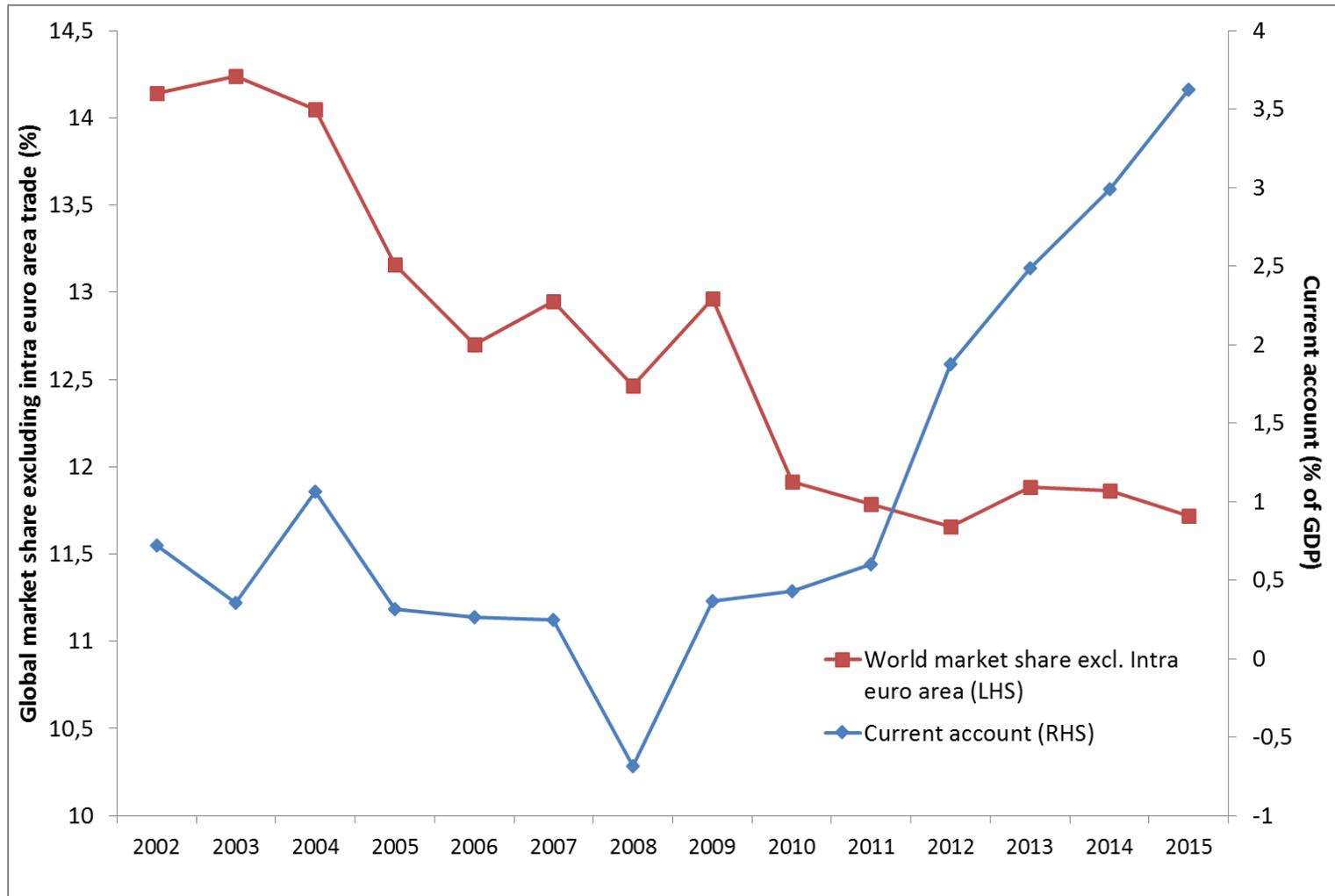
# Contributions in €area current accounts (percent of euro area's GDP)



Source: Ameco.

# Objecting to the current account

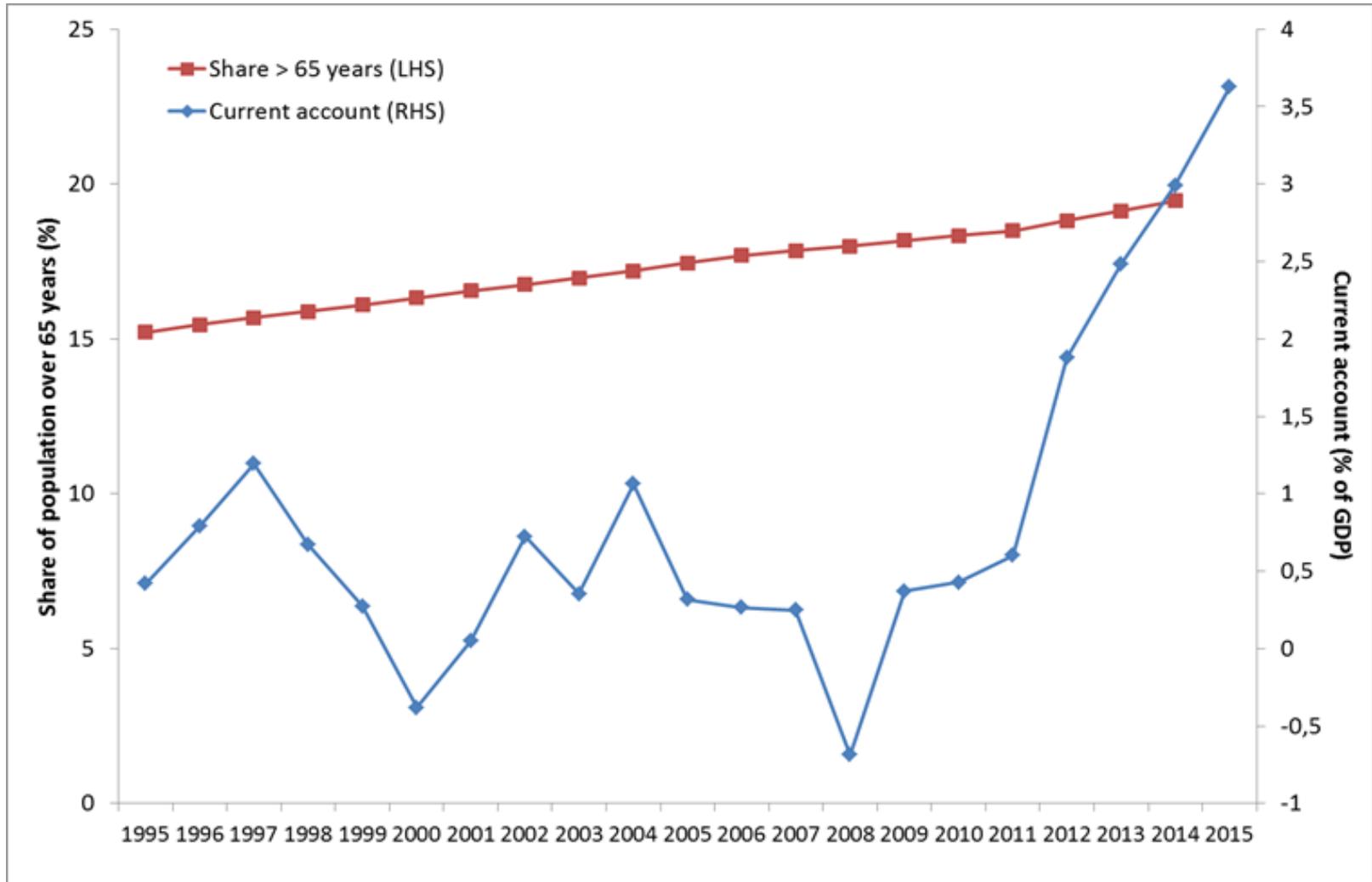
## 1. Competitiveness



Source: Ameco.

# Objecting to the current account

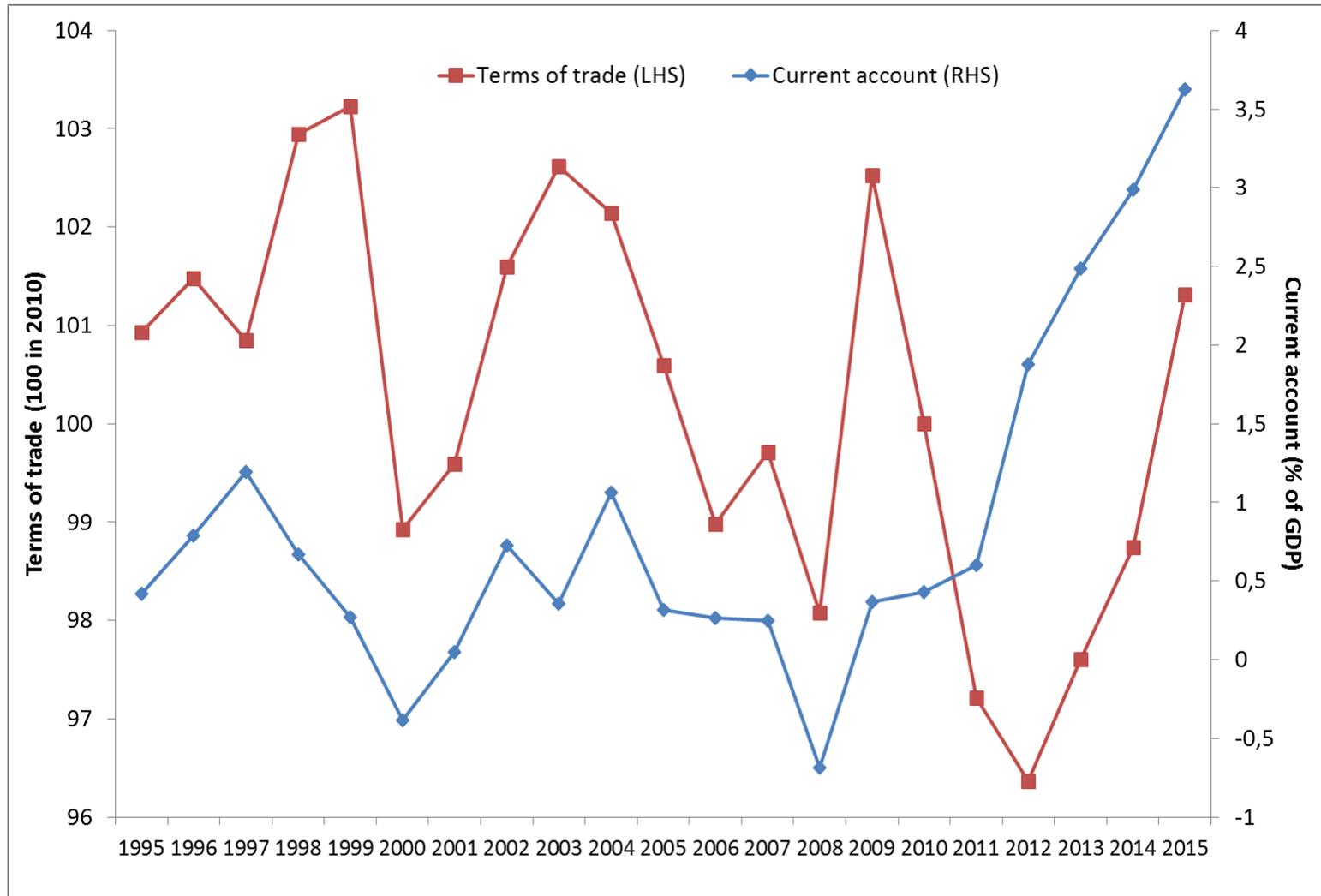
## 2. Ageing



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?

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## 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

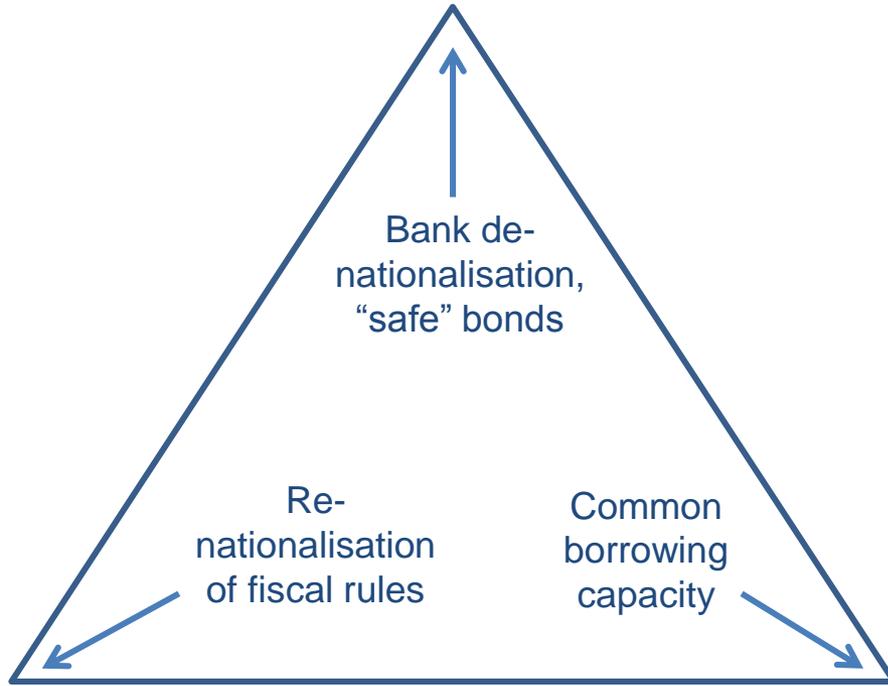
Bank de-  
nationalisation,  
“safe” bonds

Re-  
nationalisation  
of fiscal rules

Common  
borrowing  
capacity

Subsidiarity: national  
sovereignty on  
national fiscal policy

Stabilization/Solidarity:  
targeted, temporary  
automatic transfers

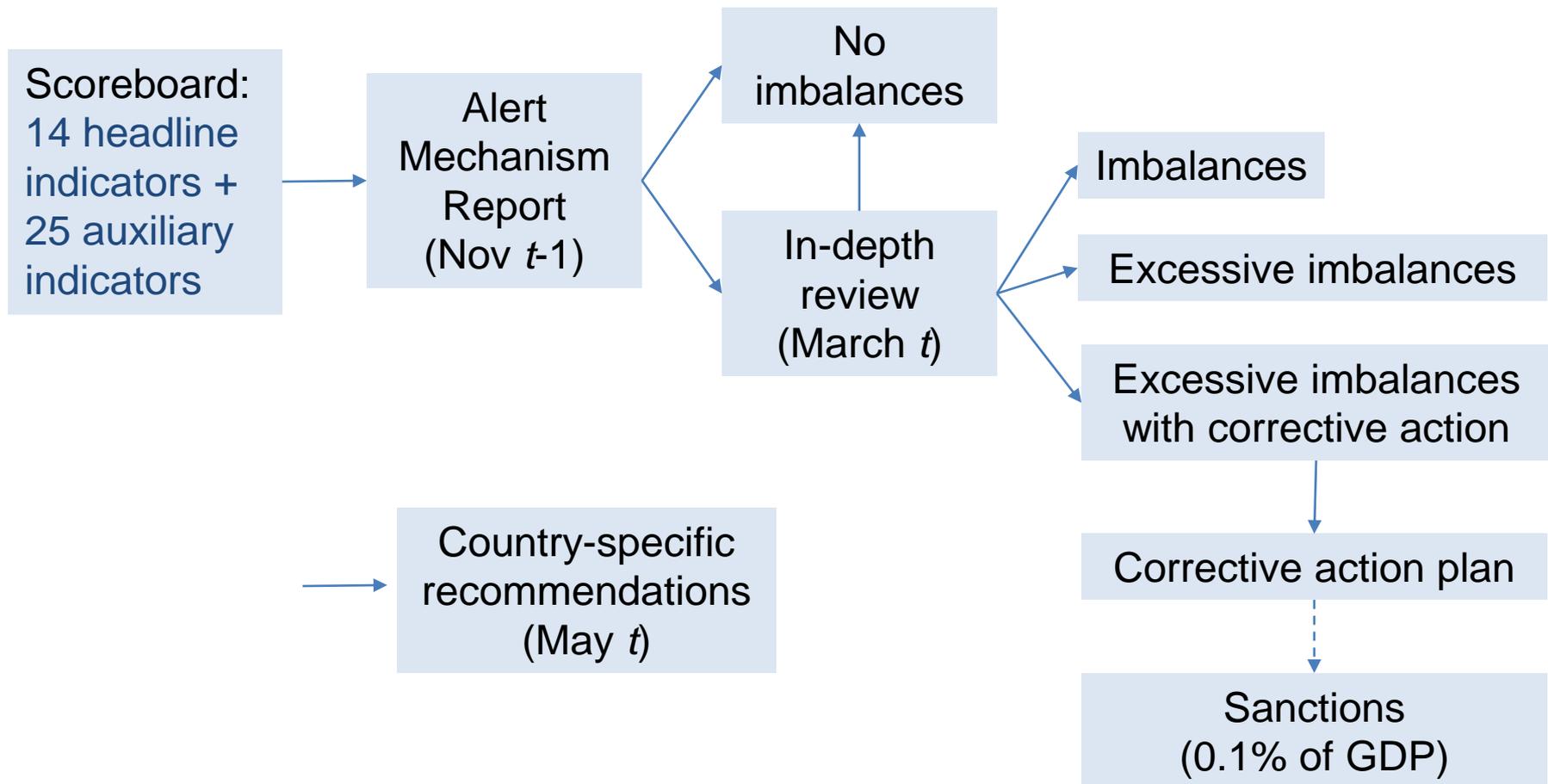


## 2. Non-fiscal policies

### **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 → duplicates the SGP
  - Same reform can appear under MIP or Europe 2020 heading

# The Macro-imbalance procedure (MIP)

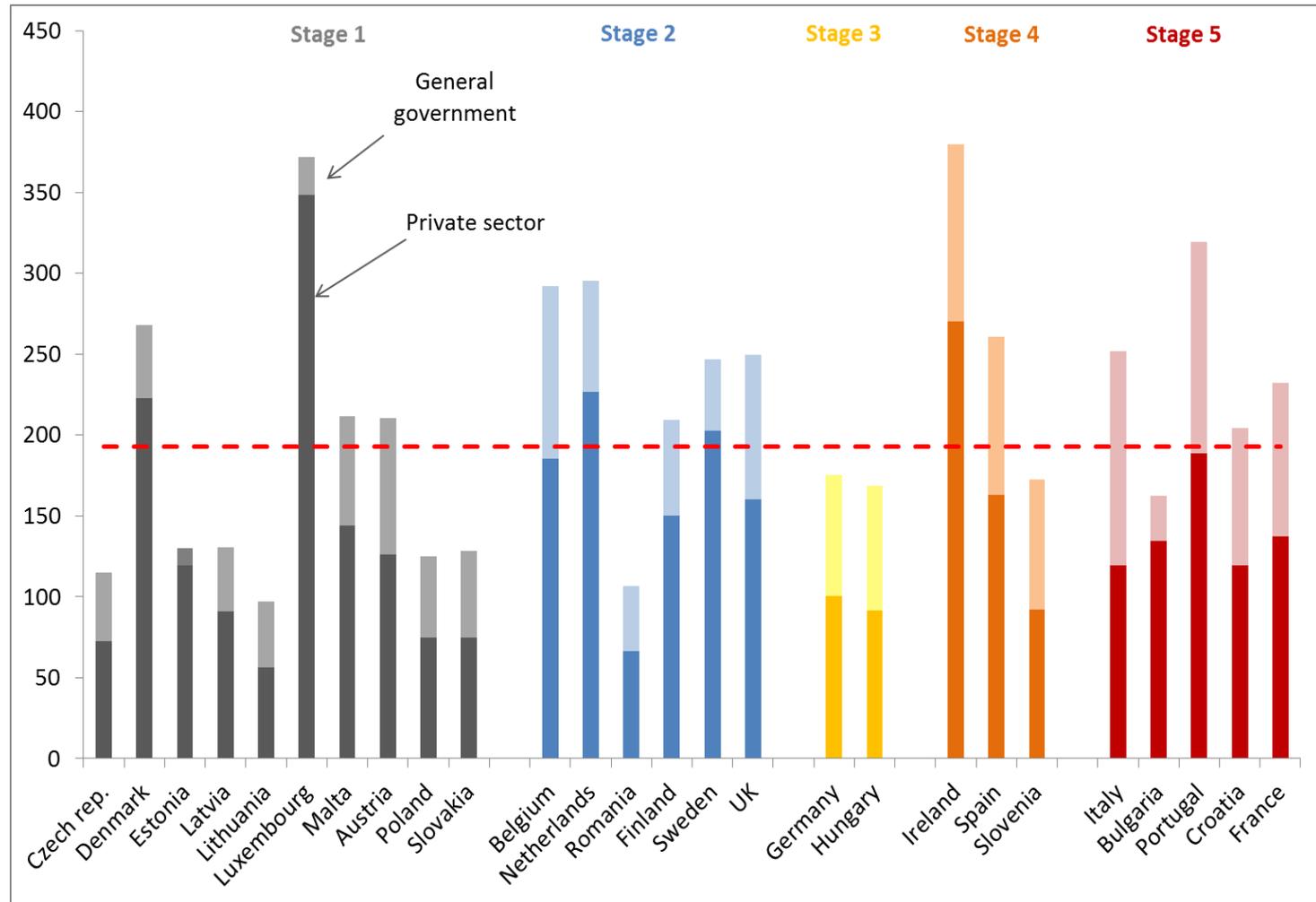


# Scoreboard headline indicators

- 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 euroarea countries and -/+11% for non-euroarea 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?

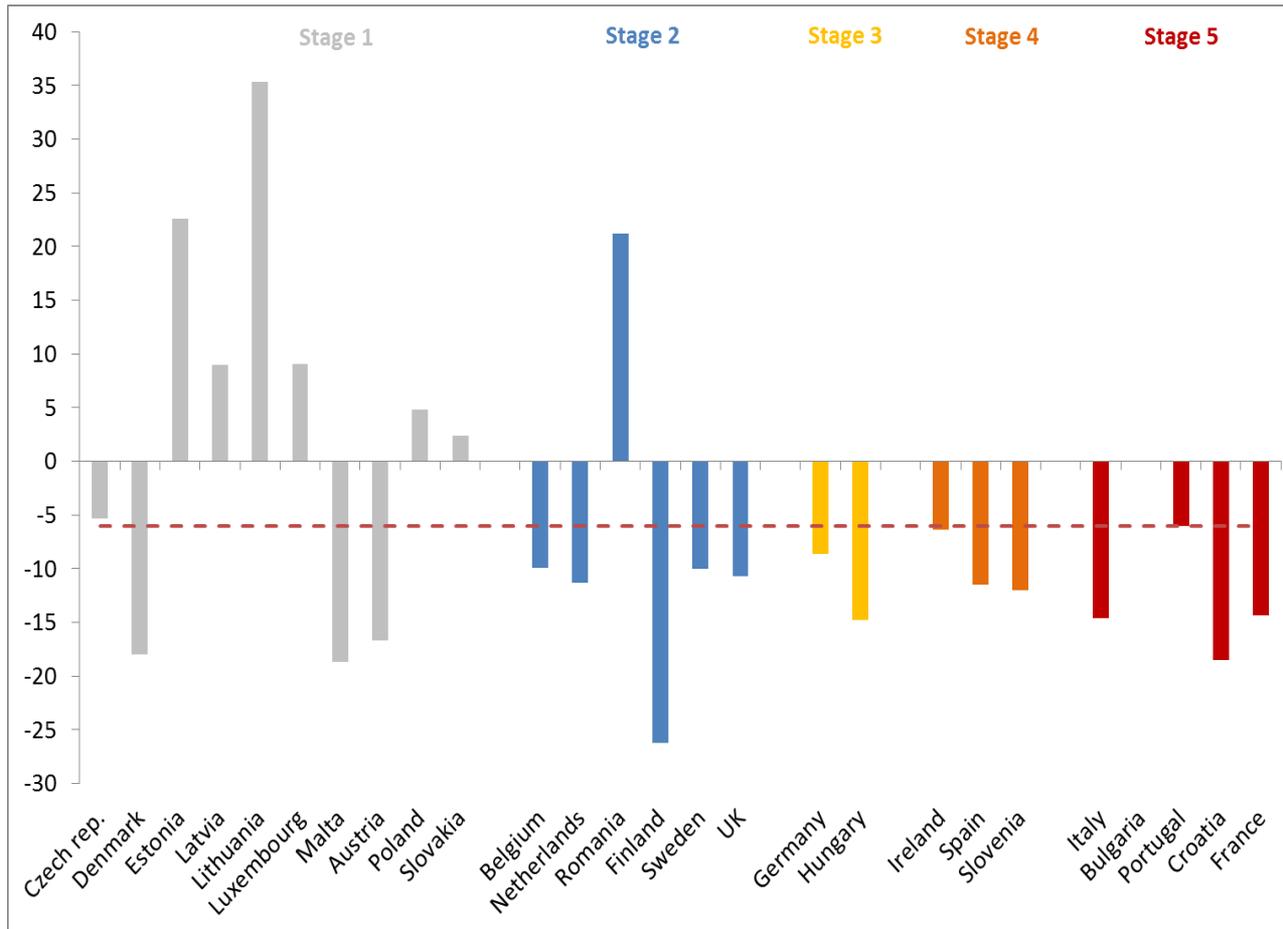
## Public and private debt, 2015 scoreboard, % of GDP



Source: 2015 scoreboard. Dotted line: 193% threshold

# Competitiveness?

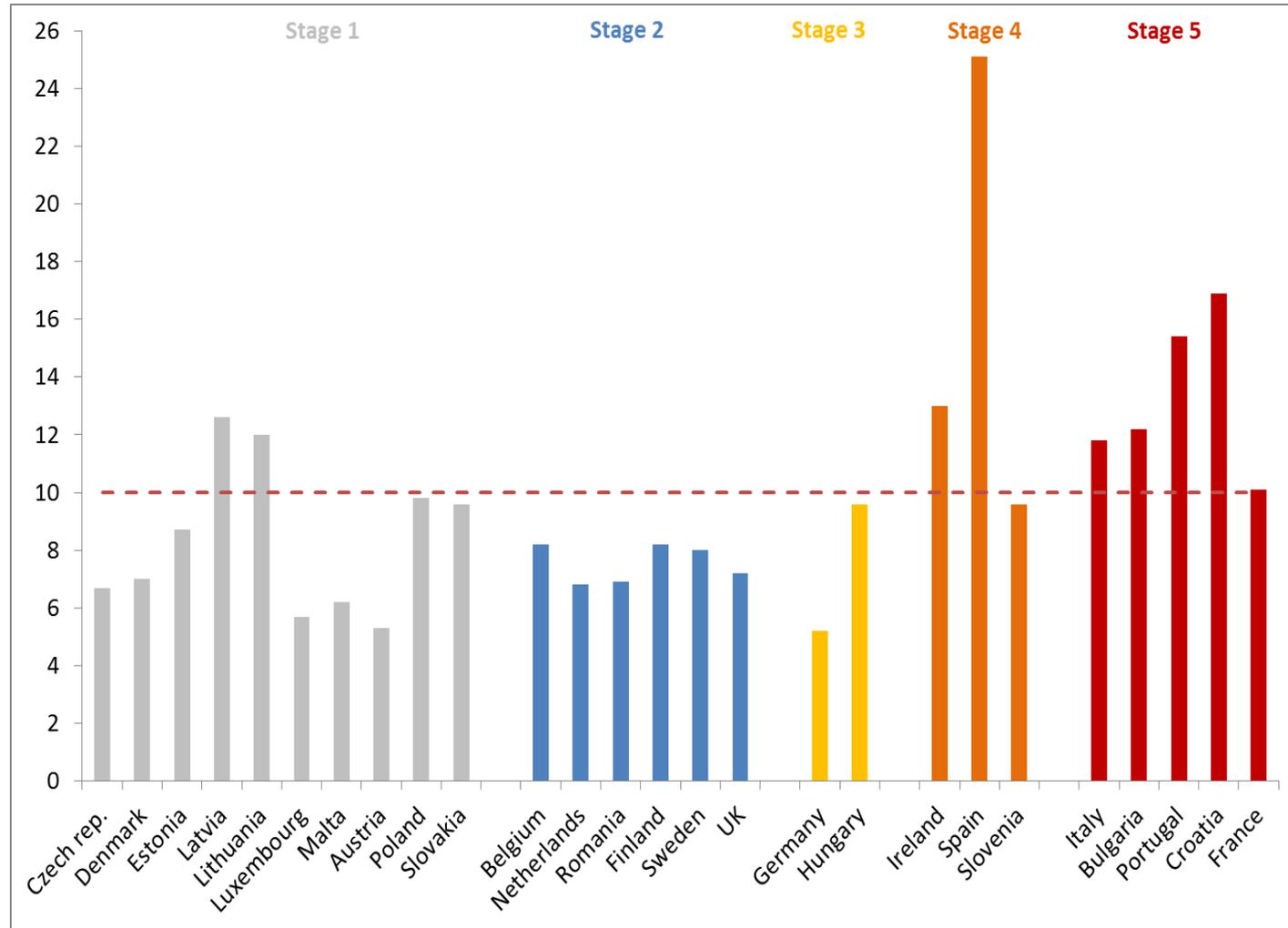
Change in export market share over 5 years  
(percent)



Source: 2015 scoreboard. Dotted line: -6% threshold.

# Unemployment!

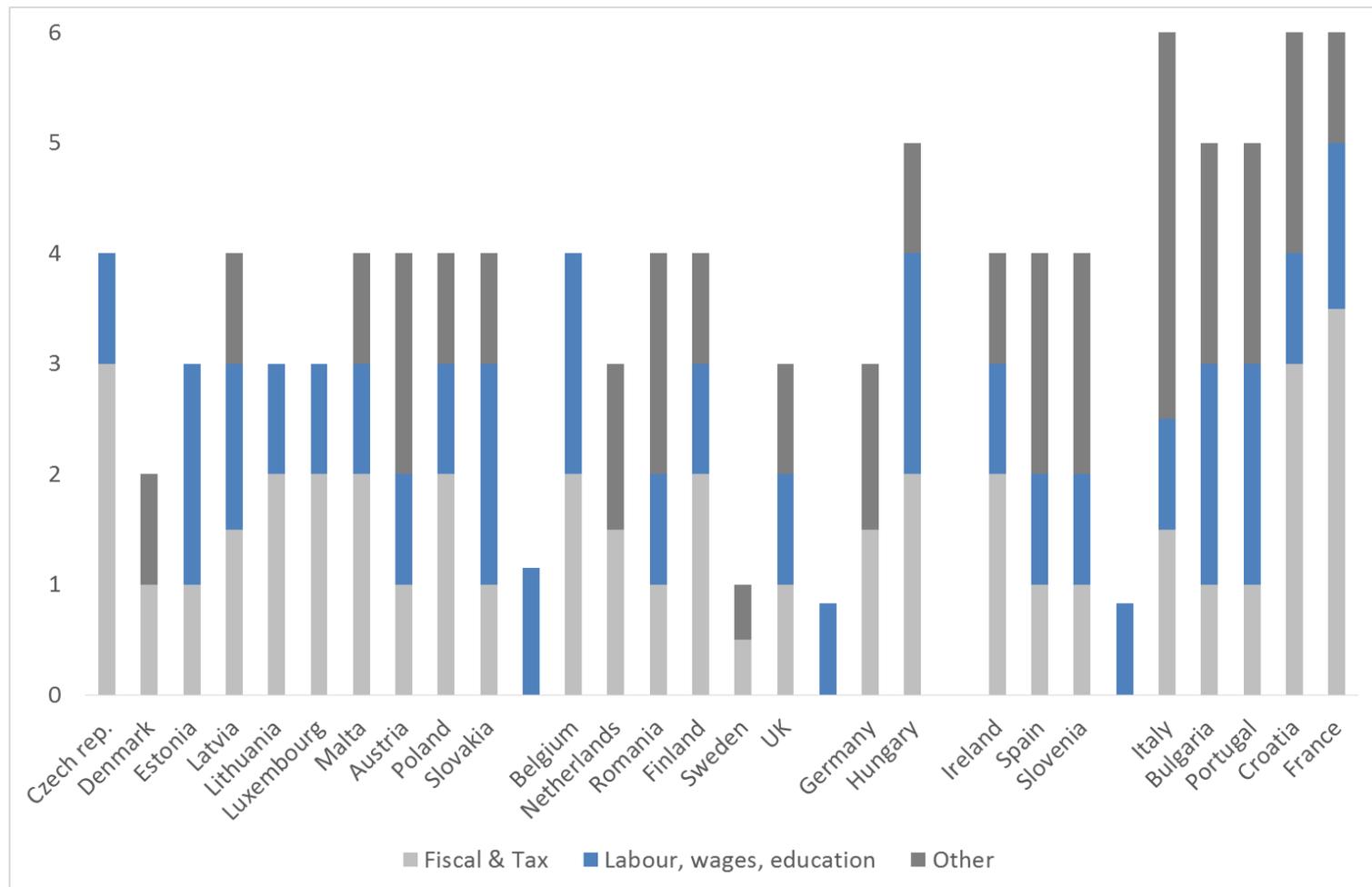
Three-year average unemployment rate, % of labour force



Source: 2015 scoreboard. Dotted line: 10% threshold.

# But no clear transcription in CSRs

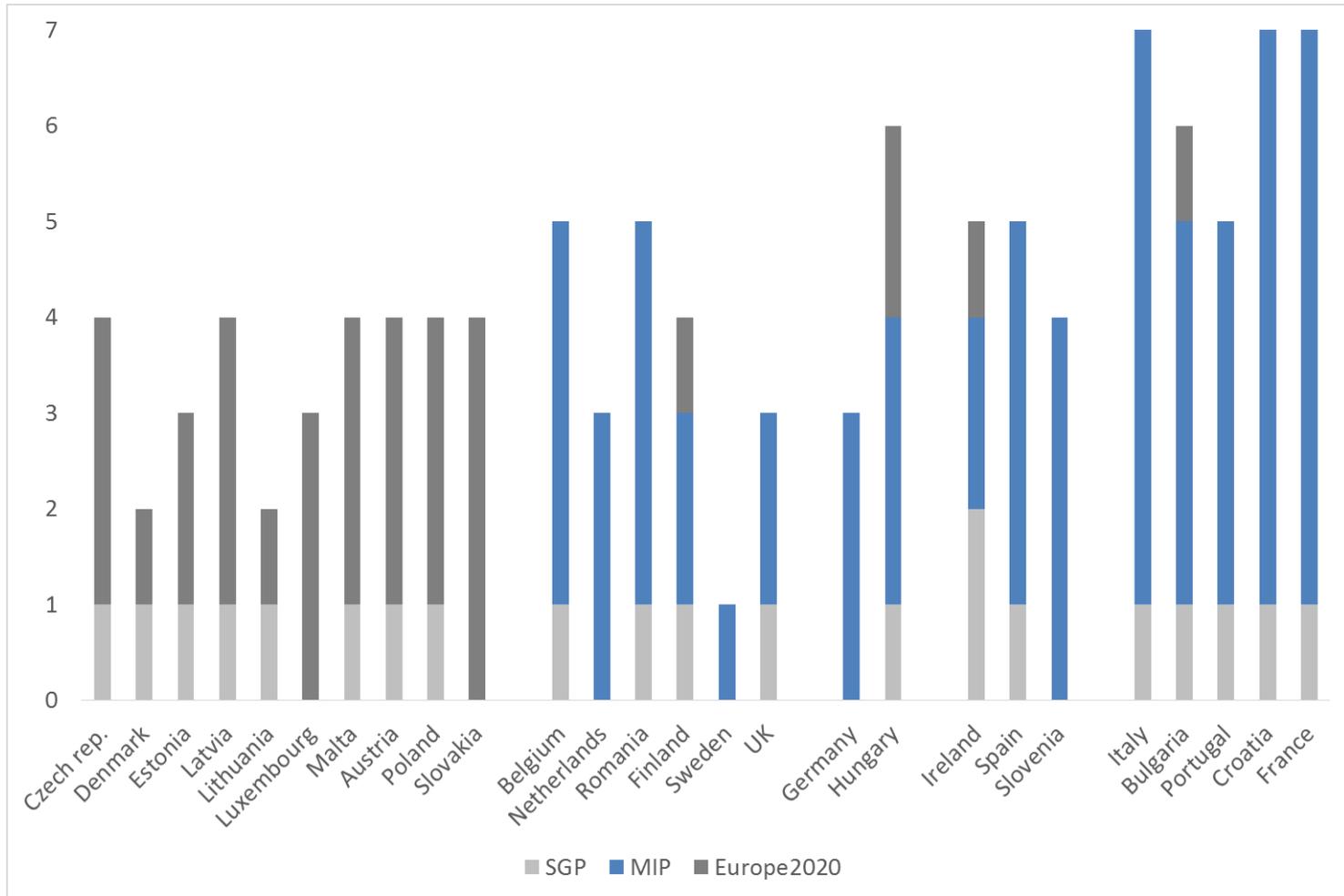
## Number of CSRs per policy area in 2015



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.

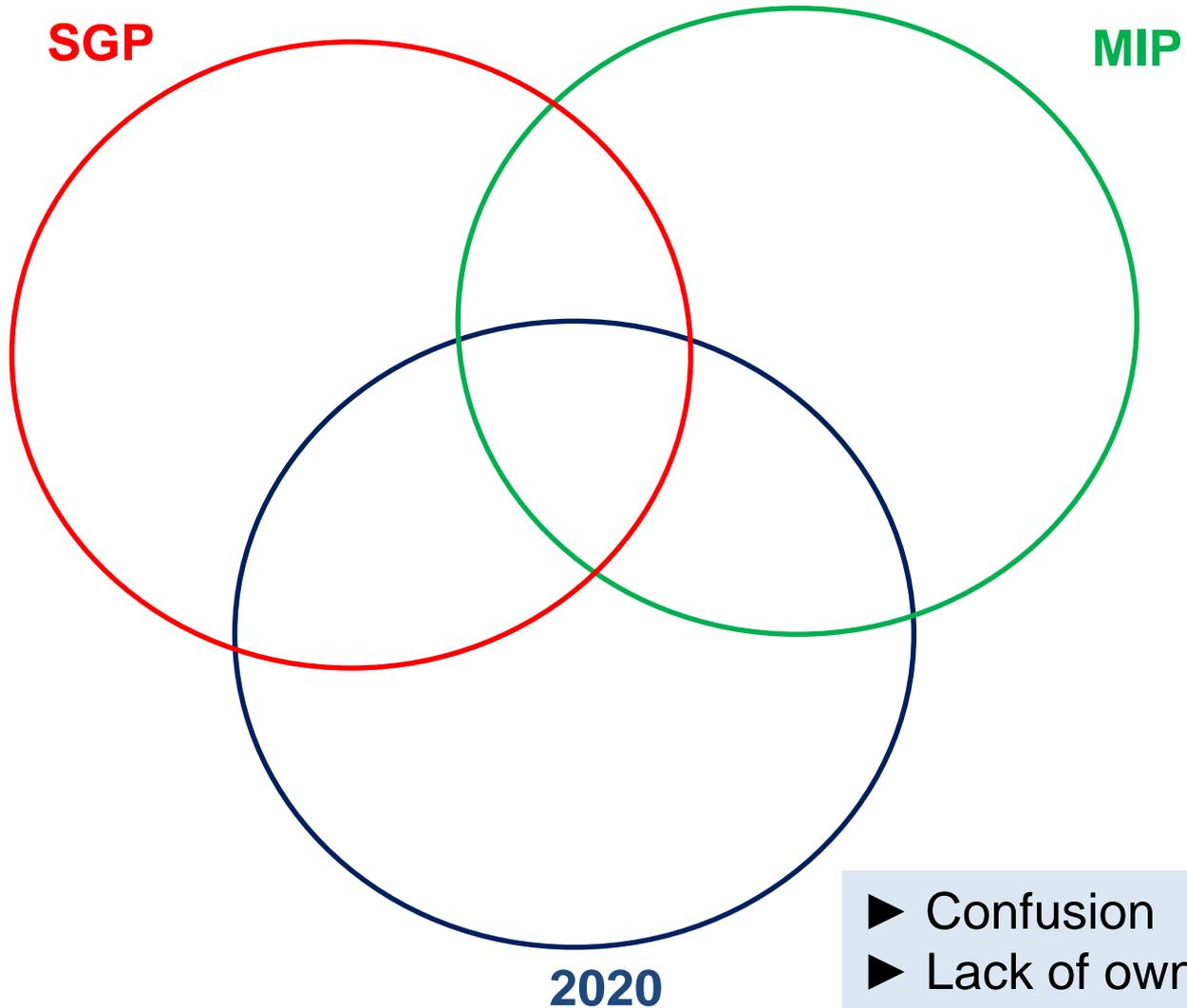
# CSRs cover SGP, MIP and 2020 “integrated guidelines”

## Number of CSRs of each category in 2015



Source: European Parliament, “Country Specific Recommendations for 2014 and 2015: A comparison and an overview of implementation”, 25 August 2015, and own calculations. Recommendations related to both the SGP and the MIP are counted twice here.

# Overlaps



- ▶ Confusion
- ▶ Lack of ownership
- ▶ Lack of time frame

# Clarification needed

**SGP**

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

**MIP**

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

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

**2020**

# 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



## Short term

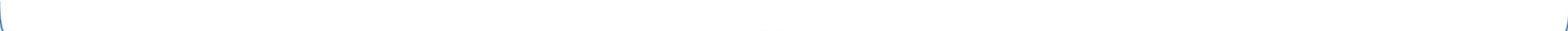
1. NPLs// bail-in rules  
→ common fiscal backstop
2. Fiscal coordination

## Medium term

1. Bank de-nationalization  
→ asset divers., EDIS
2. ESM: size, liquidity /sustainability, contagion
3. Econ. governance  
→ simplification

## Longer term

1. Capital market union  
→ legal convergence
2. Job market union: mobility, opportunities, protection  
→ structural conv. (≠ full harmonization)
3. Fiscal capacity



**No treaty change, but ideological convergence needed**

# References

- “Euro area fiscal stance: definition, implementation and democratic legitimacy”, Report for the European Parliament, Economic and Monetary Affairs Committee, July 2016.
- “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.