Professor
Stefan
Collignon

Reinventing Europe

Rapporto Europa 2018

Professor Stefan Collignon

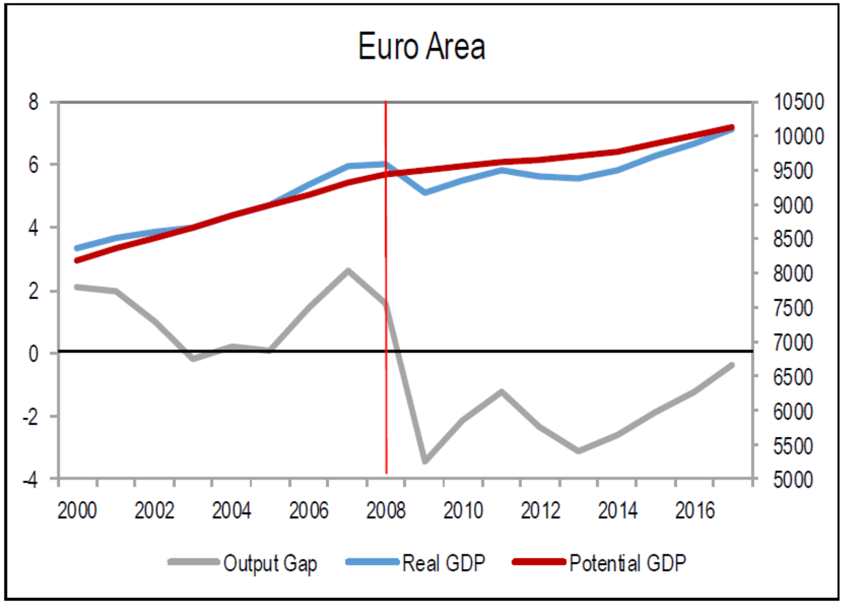
Table of Content

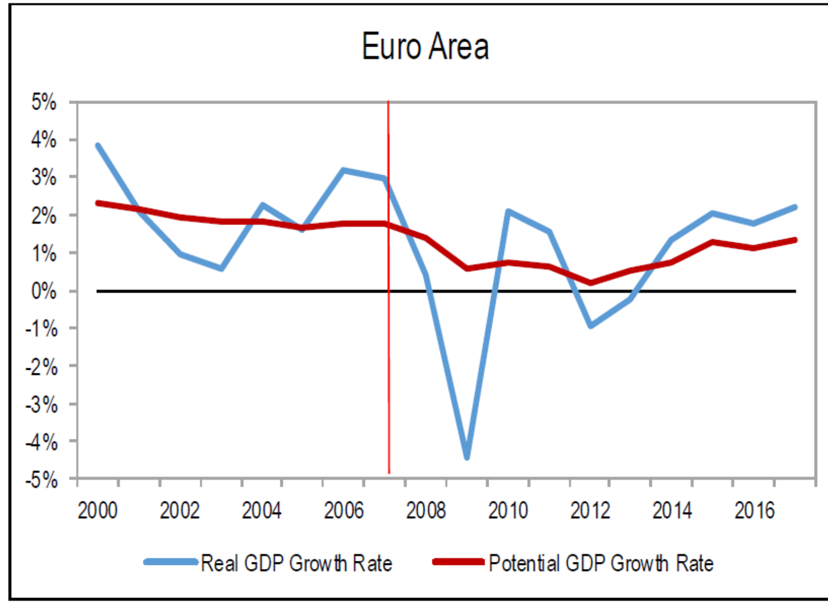
I. The Return of Economic Growth in Europe

Professor Stefan Collignon

GDP growth is expected to grow by 1.6 percent in 2017 reaching a level similar to the United States

Figure 1. Economic activity and growth in the Euro Area

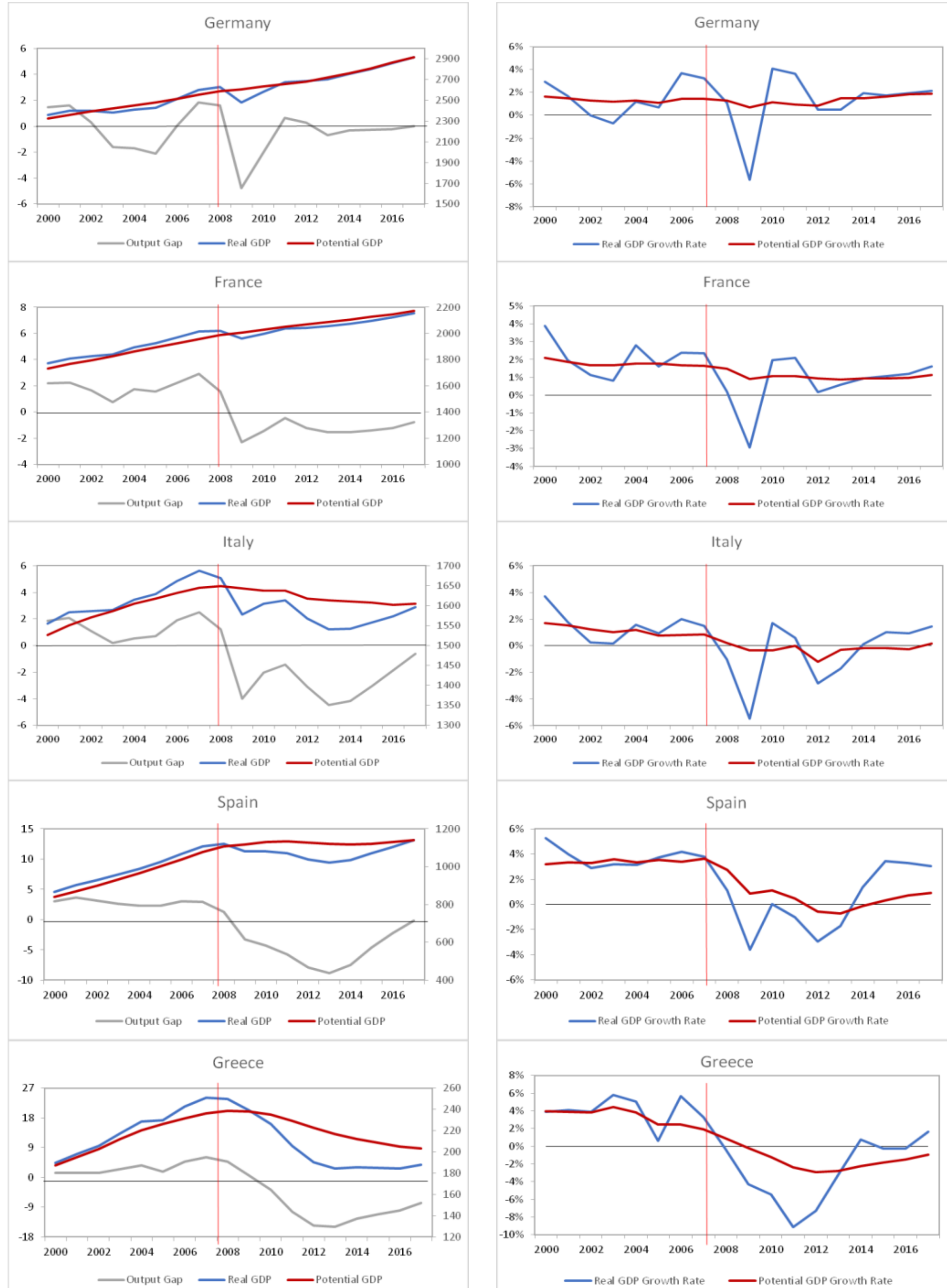




Source: European Commission AMECO database.

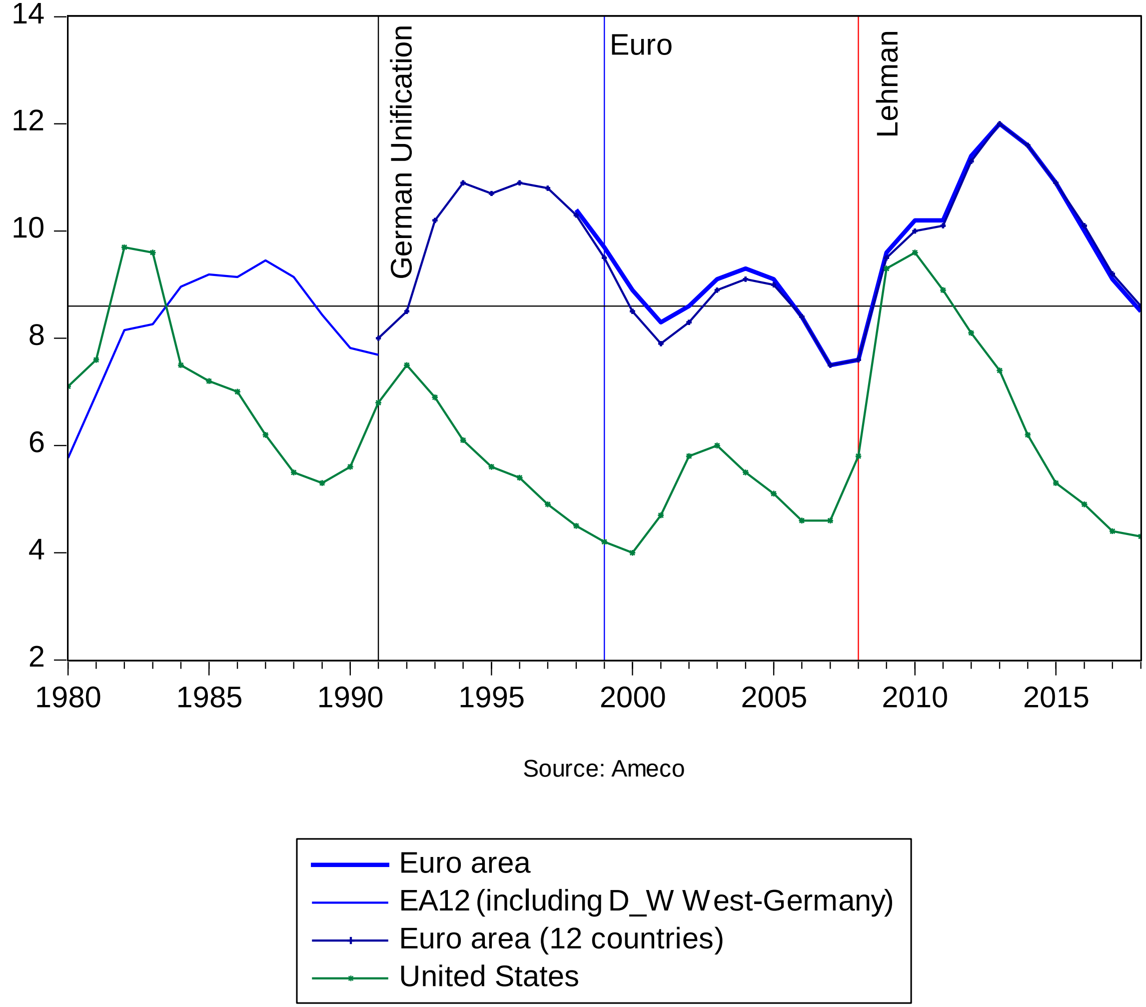
Professor
Stefan
Collignon

Figure 2. Economic activity and growth in selected Member States



Unemployment rates

Lower than when the euro started

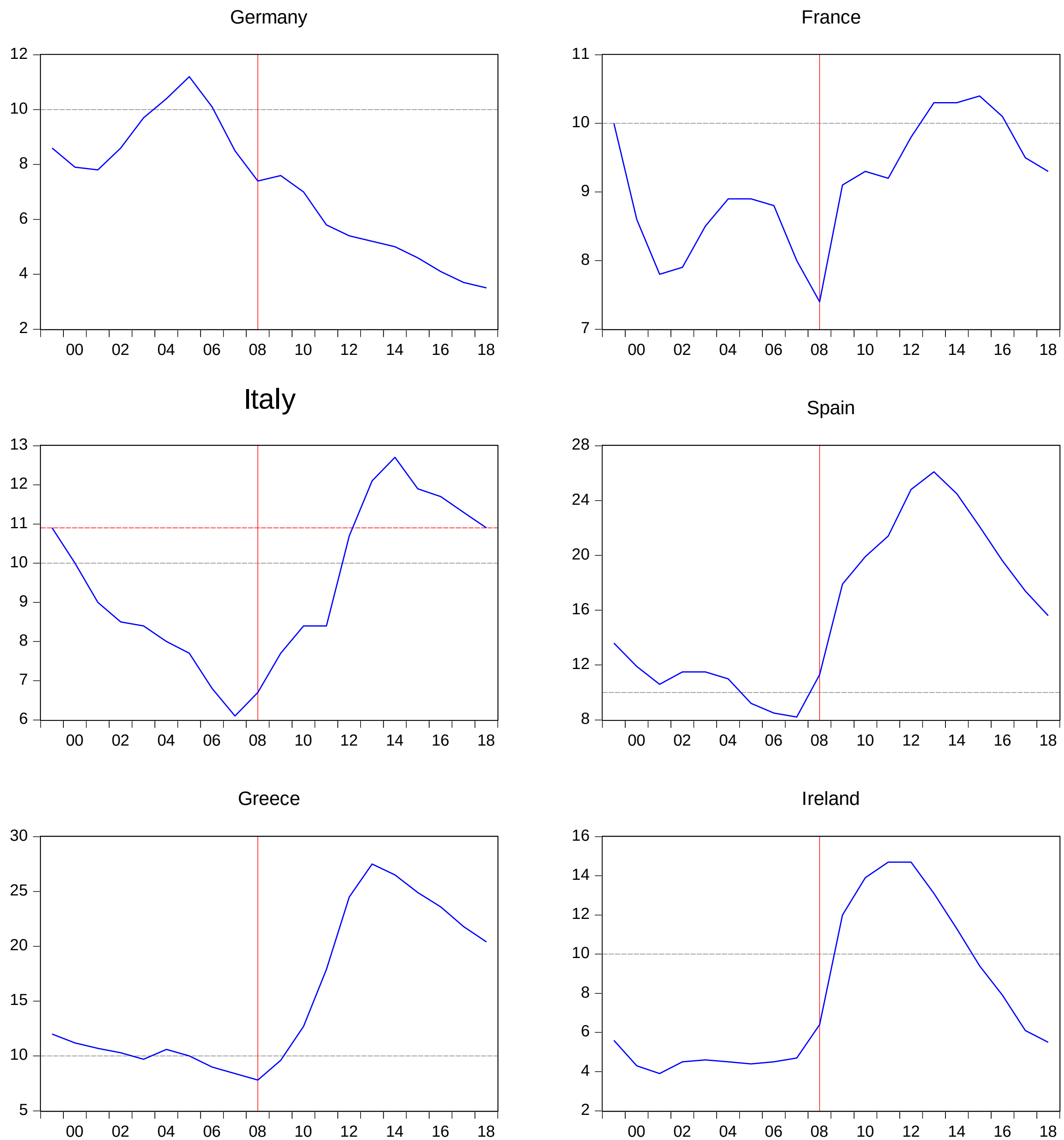


Source: Ameco

Professor Stefan Collignon

Unemployment Rates

In Italy same as when the euro started

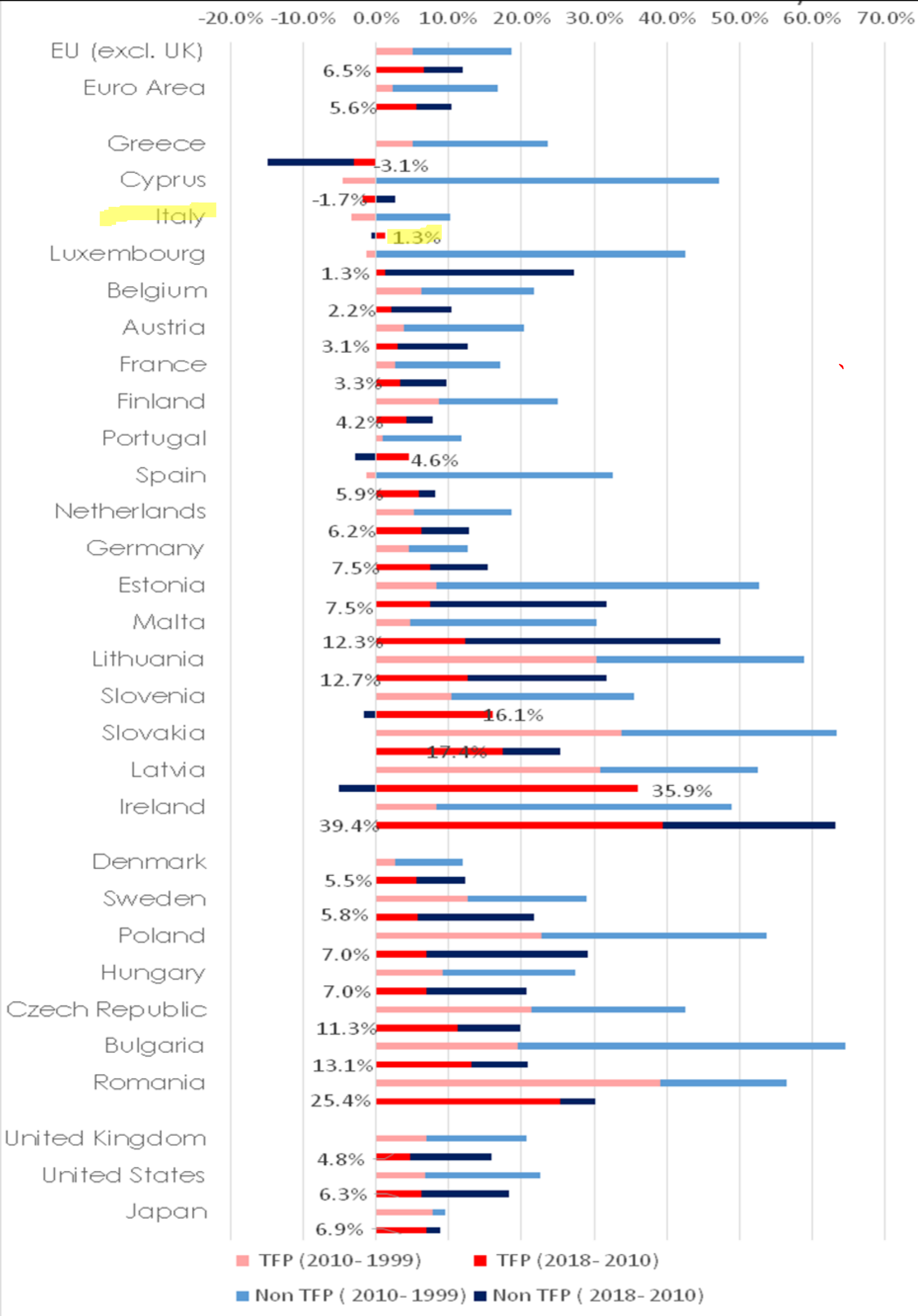


What determines economic growth?

- Short term: output gap and demand management
  - Investment
  - Wage developments and competitiveness
  - Monetary and fiscal policy
- Long term: total factor productivity
  - Structural factors
  - Education and skills of work force
  - R&D

Professor Stefan Collignon

Figure 5
Economic Growth and Total Factor Productivity



- Italy between **2000 and 2010**
  - GDP grew by 7%
  - TFP fell by -3.3%, so that extensive growth through expanding uses of factors of production was 10.3%.
- between ***2010 and 2018***
  - GDP only by 0.8% between 2010 and 2018 (equivalent to 0.1% per year).
  - TFP has now improved by a meagre 1.3% (equivalent to 0.16% per year),
- The **Italian demand boom of the first decade** put more people to work, but their **efficiency declined**.
- During the crisis years, this has changed.
  - extensive use of labour and capital has fallen by 0.5%, so that observed growth is only 0.8%.
  - Structural reforms show improved productivity

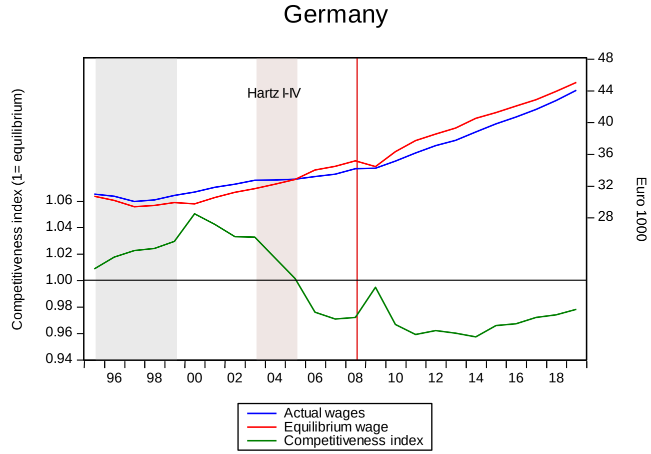
Competitiveness

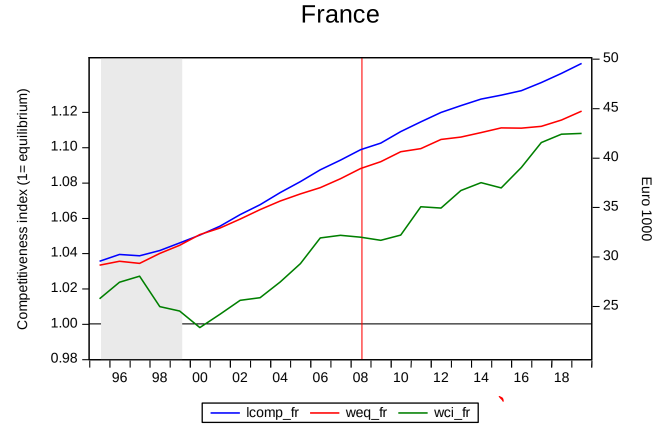
- The CER wage competitiveness index
- Deviation from equilibrium wage
- Determined by
  - the assumption of equal return to capital
  - Relative productivity

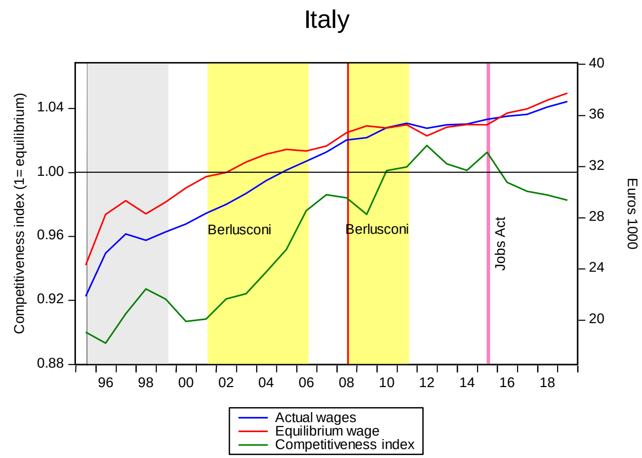
CEr CENTRO EUROPA RICERCHE

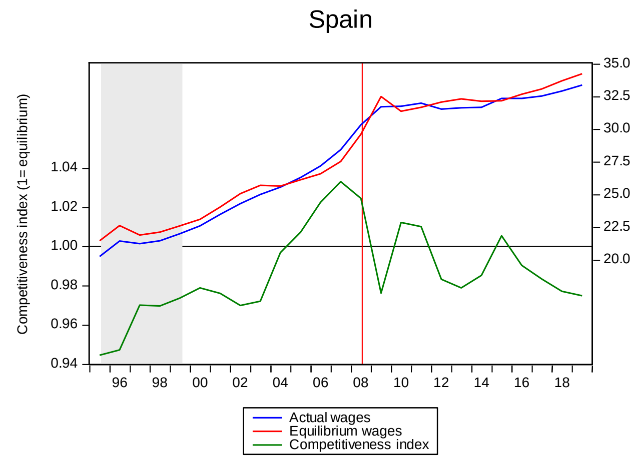
Professor Stefan Collignon

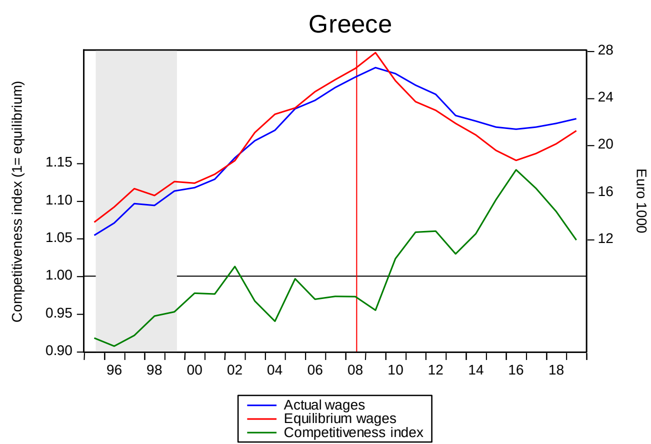
Wage competitiveness

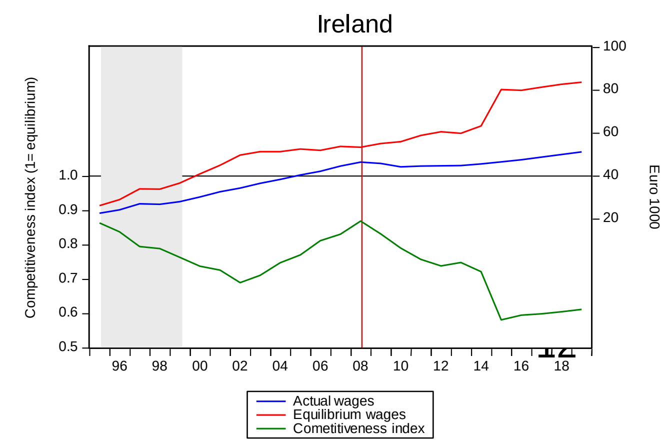






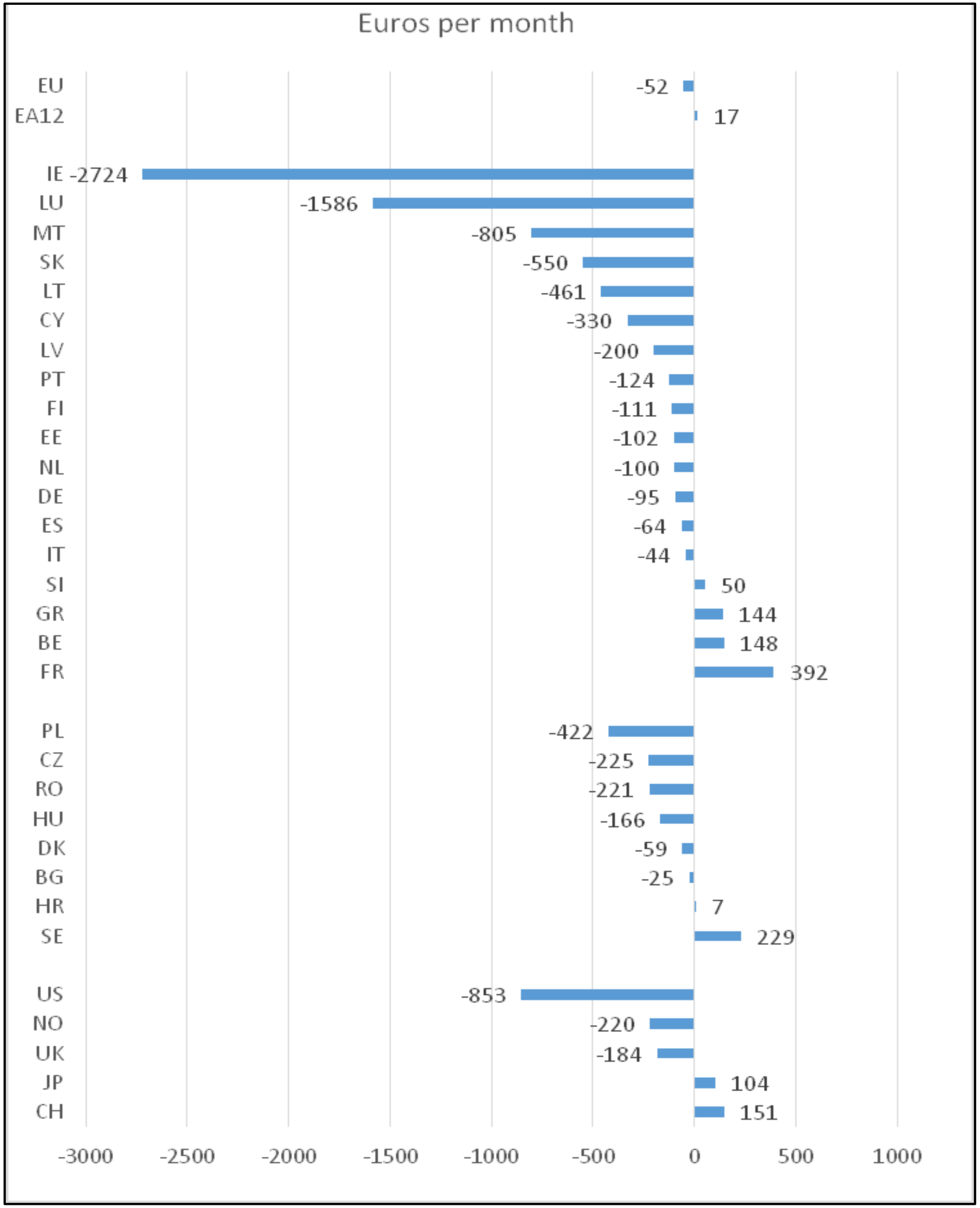






Professor Stefan Collignon

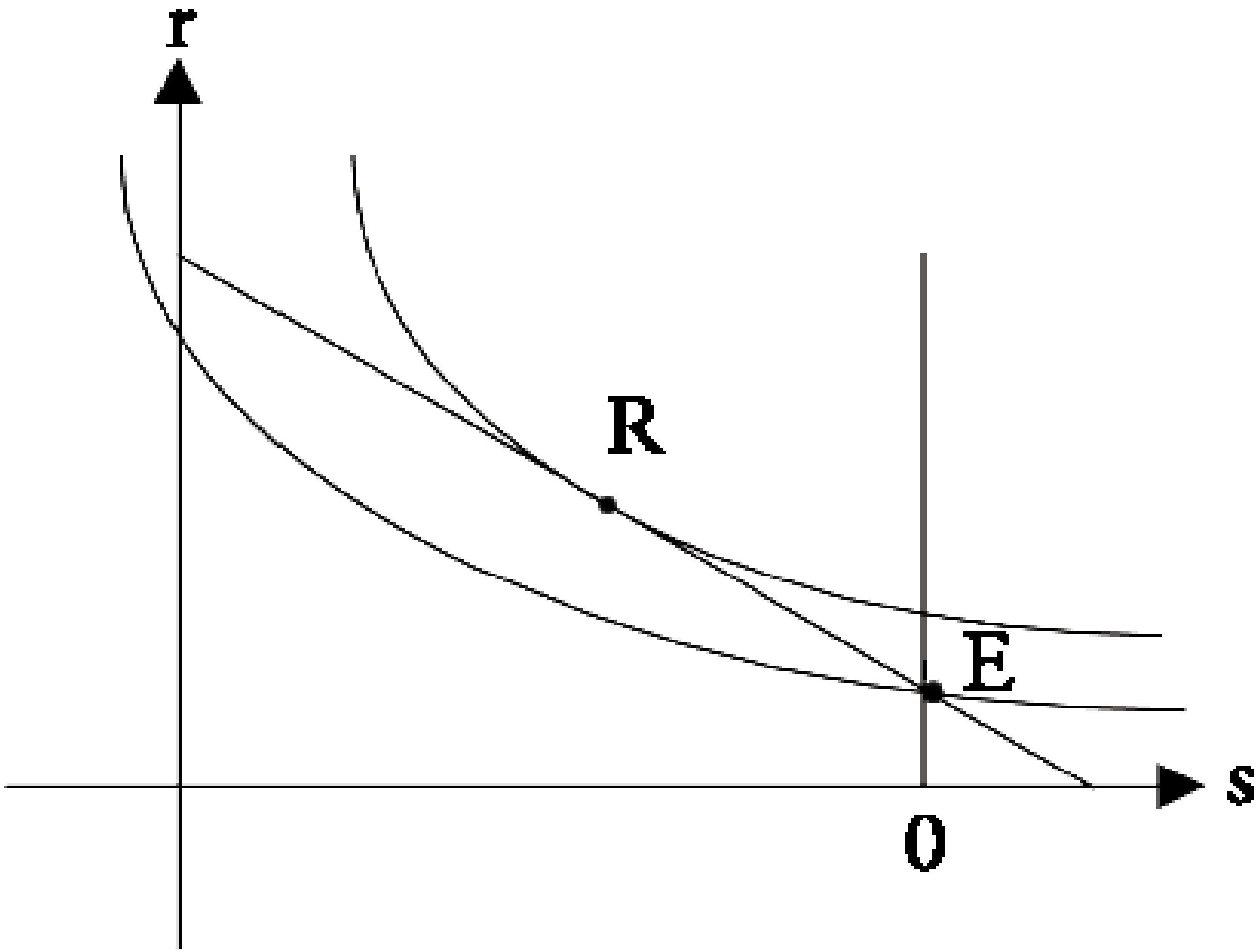
Figure 7
Wage gaps



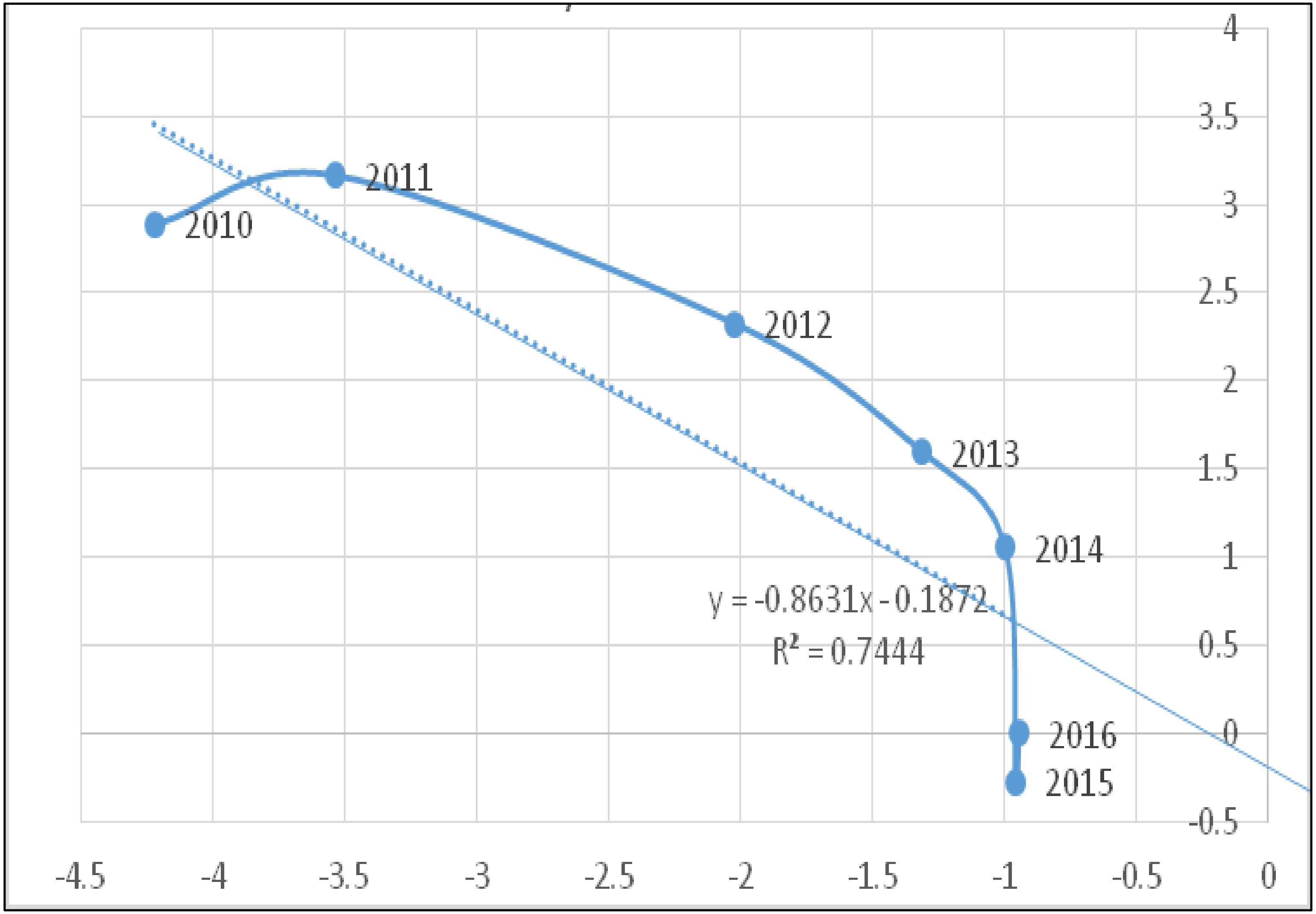
II. Policy mix

- The Euro Area has a **unique set of policy rules** and institutions, which makes policy coordination difficult
- **Monetary** policy is centralized by the independent European Central Bank
- **Fiscal** and economic policy is decentralized in the hands of sovereign member states,
  - which are, however, constrained by a set of rules such as the Stability and Growth Pact and the new Fiscal Compact
  - Because total public expenditure in the Euro Area is around 45% of GDP, the role of public spending is of prime importance for the performance of aggregate demand.

The interaction between fiscal and monetary policy



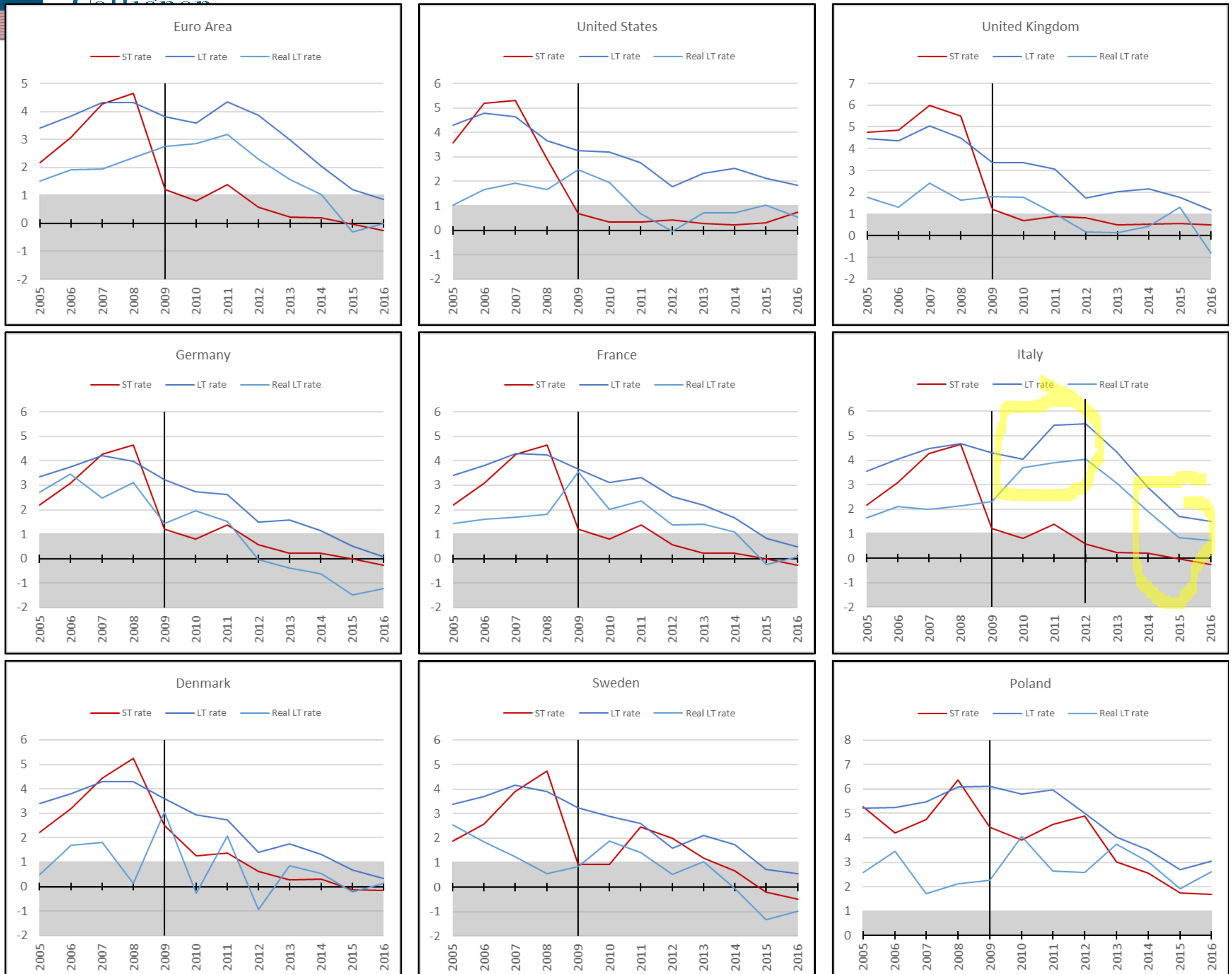
The policy mix in the Euro Area



ECB is the only game in town

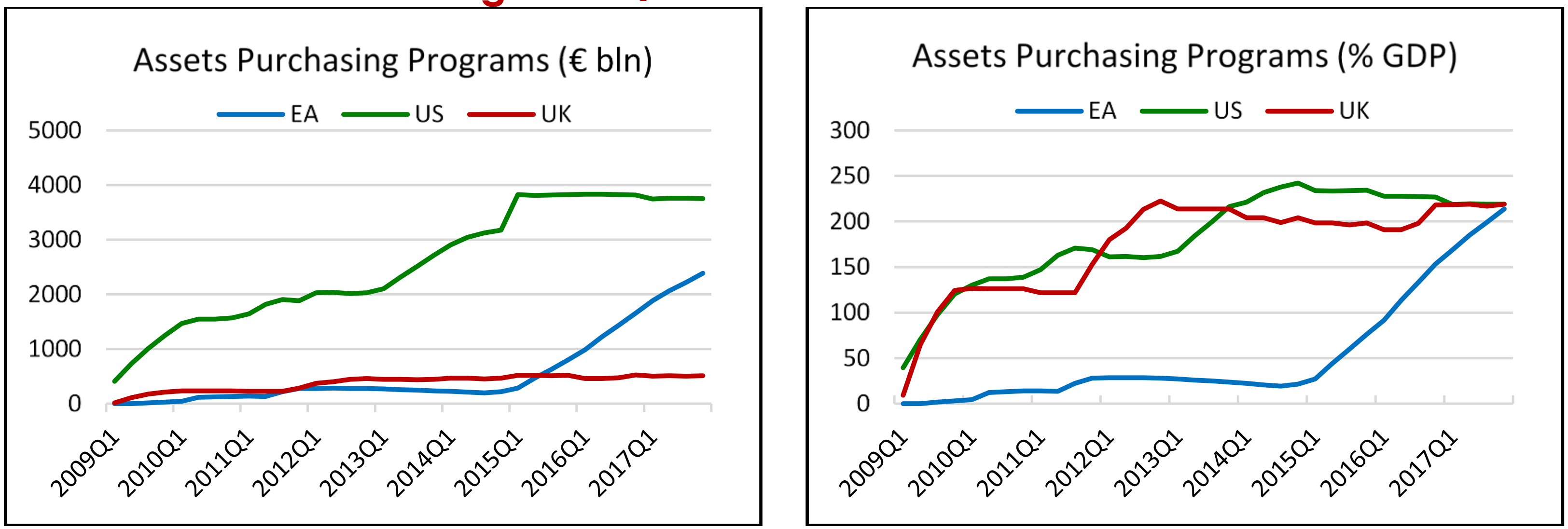
Professor
Stefan
Collignon

Long-term and short-term interest rates



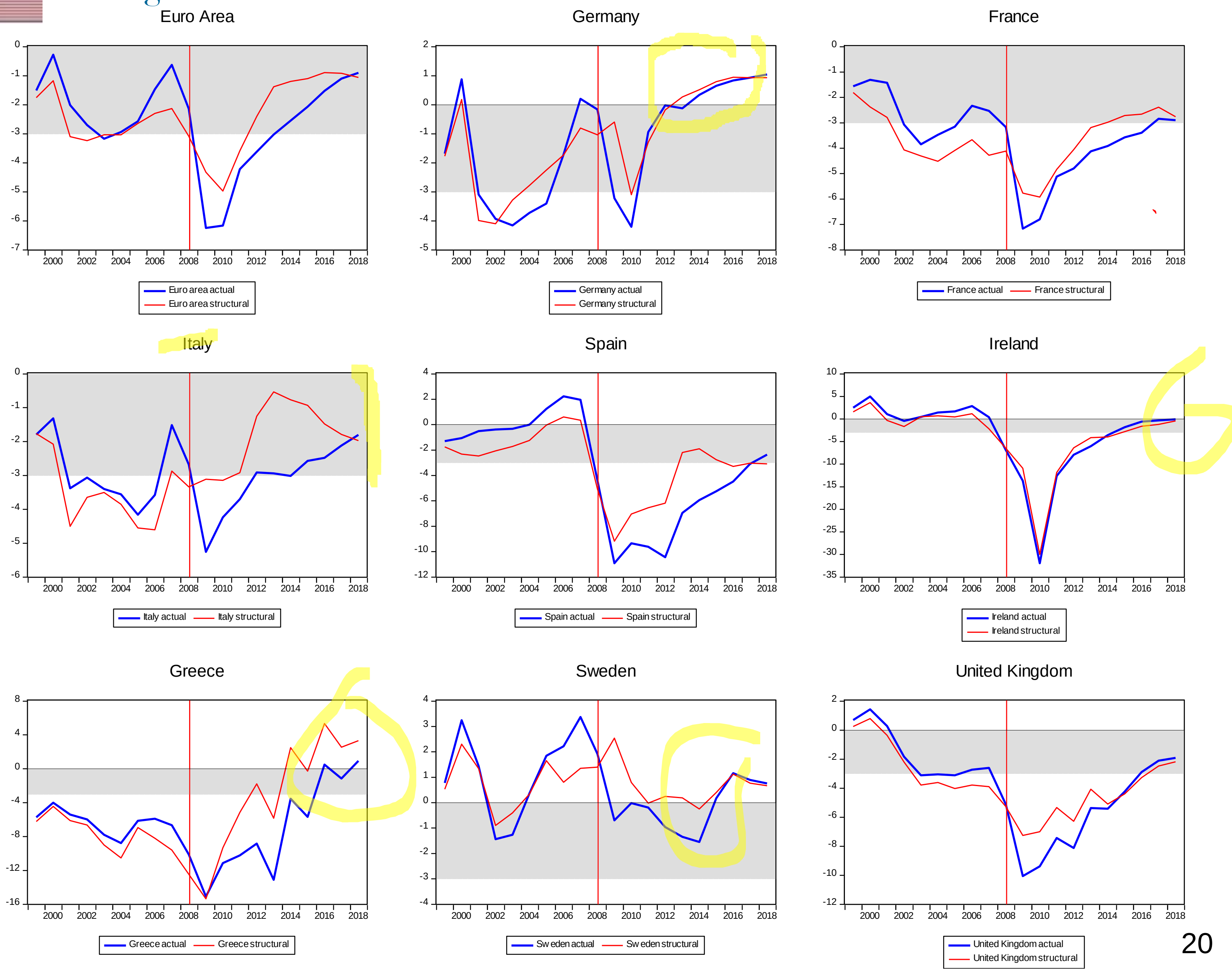
- The higher interest rates for Italy reflect risk premia on high government debt levels.
- ECB Public Sector Purchasing Program is not large for Italy
  – Italy is not a program country

Figure 1 QE in advance economies



Professor
Stefan
Collignon

Figure 15 Budget positions in Europe



Professor Stefan Collignon

Table 1. Public debt in the Euro Area

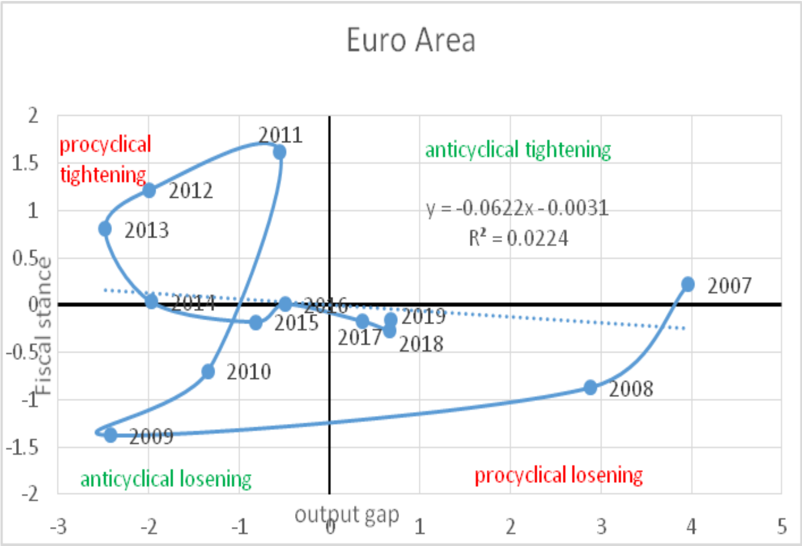
Italy:
€ 2341 bn

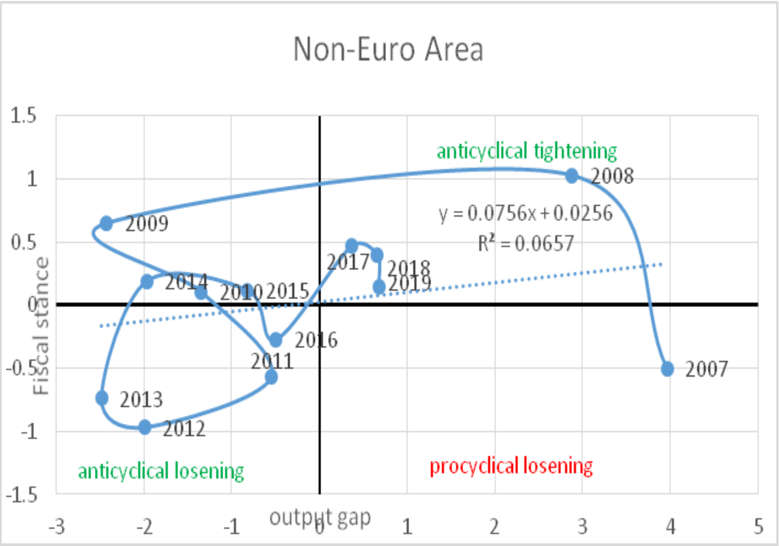
Germany:
€ 2035.9 bn

Euro Area Countries			Non-Euro Area Countries	
	Debt/GDP (%)	Share of EA debt		Debt/GDP (%)
Euro area (EA12)	88.1	100.0%		
Greece	177.8	3.3%	Bulgaria	24.3
Italy	130.8	22.8%	Czech Republic	33.3
Portugal	124.1	2.5%	Denmark	35.5
Belgium	102.5	4.6%	Sweden	36.6
Cyprus	98.3	0.2%	Romania	39.1
Spain	96.9	11.6%	Poland	53.0
France	96.9	22.6%	Hungary	71.5
Austria	76.2	2.9%	Croatia	77.4
Slovenia	74.1	0.3%	United Kingdom	85.3
Ireland	69.1	2.1%	United States	108.4
Finland	62.1	1.4%	Japan	239.1
Germany	61.2	20.6%		
Netherlands	54.9	4.2%		
Malta	51.6	0.1%		
Slovakia	49.9	0.4%		
Lithuania	37.9	0.2%		
Latvia	35.5	0.1%		
Luxembourg	23.0	0.1%		
Estonia	9.1	0.0%		

Source: European Commission AMECO database.

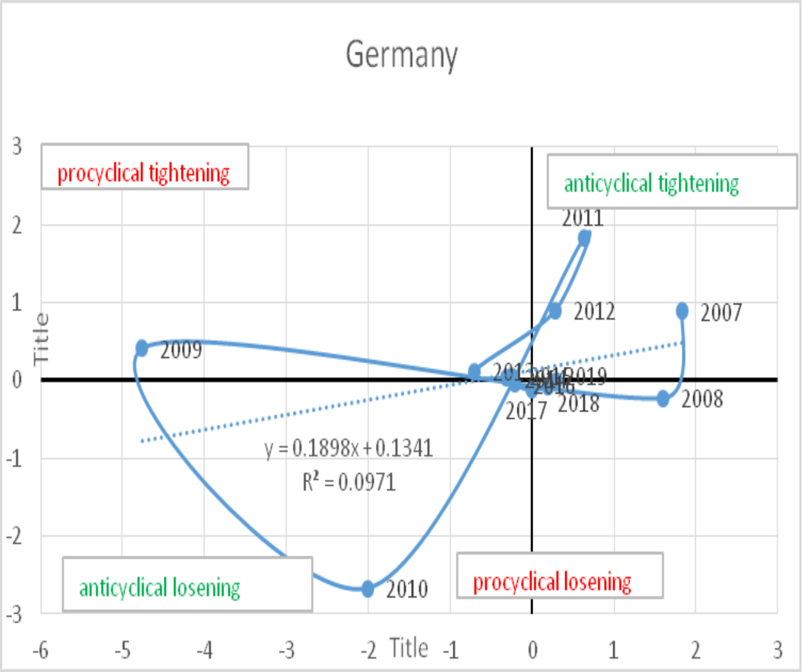
- The **fiscal policy stance** is defined as the change in the primary structural budget position
- Fiscal **stimulus** can help to close output gap
- Fiscal **consolidation** is required when output gap is positive

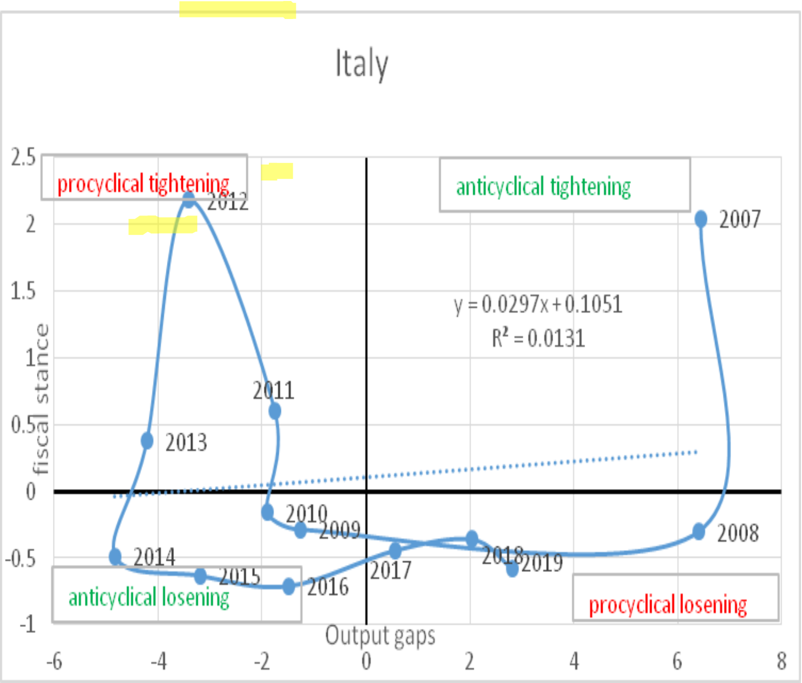




Professor
Stefan
Collignon

- In Italy, austerity was pro-cyclical during the Monti years
- A consequence of the loss of credibility under Berlusconi
- PD governments were behaving anticyclical
- Today, fiscal stance is pro-cyclically loose





III. Fiscal Union

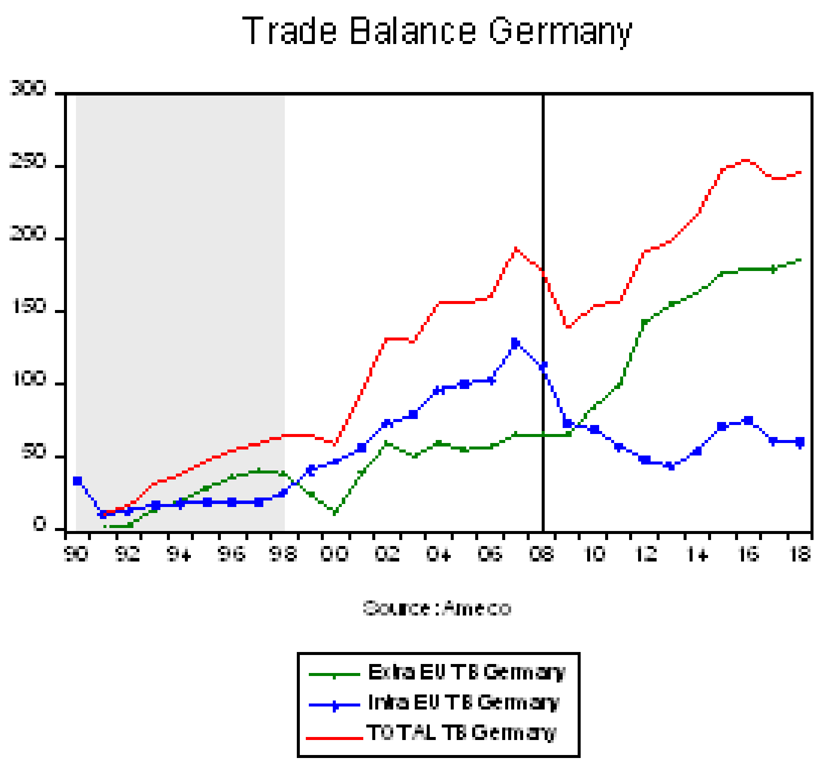
Macroeconomic imbalances

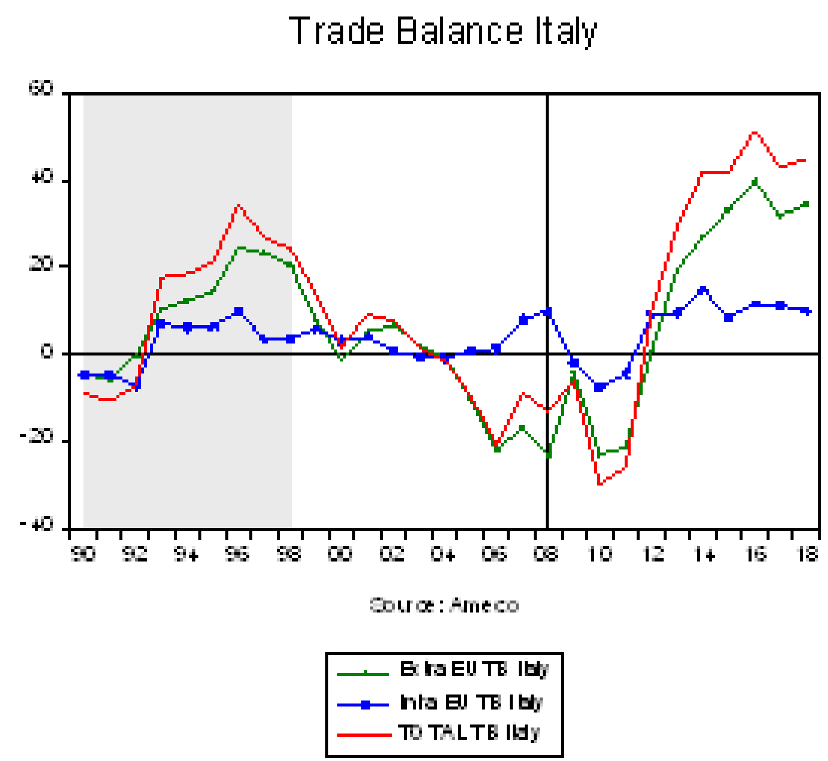
- It has been argued that the problems encountered by some member states are due to macroeconomic imbalances
  - especially in the south,
- The orthodox discourse: excessive borrowing by state or private sector
- The populist discourse: Germany’s surplus has inhibited the South
- The correct discourse: EMU is not a fixed exchange rate system

Macroeconomic imbalances

- As a consequence, fiscal policy spills over into other member states (=regions)
- How important are these externalities?

Figure 20 Trade balances in Germany and Italy





Flow of Funds Analysis

- Money is supplied by ECB, not current account
- Lending and borrowing from 4 sectors
  - Households
  - Corporations
  - Government
  - Rest of the world (current accounts)
- Lending and borrowing across member states

- The flow of funds

(8) $\mathbf{CA = (S - I) + (T - G)}$

(9) $CA = CA_1 + CA_2 = 0 \quad \Rightarrow \quad \mathbf{CA_1 = - CA_2}$

(10) $(S_1 - I_1) + (T_1 - G_1) = -(S_2 - I_2) - (T_2 - G_2)$

Transfer Union definition

(11) $(T_1 - G_1) = - (T_2 - G_2)$

What are the **consequences** of fiscal consolidation for the Euro Area?

– we calculate GVAR system

- **Reaction of private sector net lending** (Savings-Investment balance: S-I) to budget position (T-G) (in equilibrium)
  - Multiplier: reaction of member state in response to **local** fiscal policy stance
  - Spillover: reaction of member state in response to **another member state's** fiscal policy stance

- Zero spillover: fiscal policy is autonomous
- Negative coefficient: crowding in
  - more public borrowing increases private sector net lending
  - Less investment and consumption
  - But: **Fiscal consolidation is stimulus**
  - Interest rate channel
- Positive coefficient: crowding out
  - public borrowing reduces private savings
  - Double deficit → current account deficit
  - **Fiscal consolidation generates** more savings and **current account surplus**

Table 2. Medium run multipliers and spillovers on private net lending as a response to a shock in the government surplus (+1%)

Response Country \ Impulse Country	EURO AREA	GERMANY	FRANCE	ITALY	SPAIN	NETHERL.	BELGIUM	IRELAND	FINLAND	PORTUGAL	GREECE
Rest of EU	-0,06%	0,03%	-0,03%	-0,03%	-0,15%	-0,20%	0,05%	0,67%	-0,03%	0,40%	-0,02%
Euro Area	**-0,55%**	-0,52%	-0,32%	0,13%	-0,14%	-0,33%	0,16%	2,27%	0,88%	1,08%	-0,02%
GERMANY	-0,92%	**-1,08%**	-0,02%	0,19%	0,06%	-0,28%	0,24%	-5,77%	1,84%	1,36%	0,02%
FRANCE	-0,21%	-0,08%	**-0,83%**	0,06%	-0,02%	-0,03%	0,03%	-1,33%	-1,68%	0,19%	-0,01%
ITALY	-0,21%	-0,14%	-0,06%	***-0,05%***	-0,09%	-0,23%	0,01%	-0,68%	0,70%	0,64%	-0,06%
SPAIN	-0,56%	-0,26%	-0,52%	0,40%	**-0,93%**	-0,31%	0,18%	0,54%	3,25%	1,92%	-0,03%
NETHERL.	-0,65%	-0,54%	-0,09%	0,06%	-0,10%	**-1,41%**	0,39%	-9,73%	0,32%	1,92%	-0,09%
BELGIUM	-0,51%	-0,51%	-0,30%	-0,01%	-0,16%	-0,62%	**0,46%**	0,49%	1,72%	1,86%	0,02%
IRELAND	-1,69%	-1,67%	-0,92%	0,53%	-0,38%	-1,02%	0,09%	***5,41%***	-0,60%	0,93%	-0,11%
FINLAND	-0,47%	-0,49%	-0,38%	0,14%	0,05%	-0,20%	0,25%	-6,17%	***5,00%***	0,59%	-0,04%
PORTUGAL	-0,43%	-0,31%	-0,40%	0,21%	-0,35%	-0,32%	0,15%	-1,19%	0,44%	**1,95%**	-0,03%
GREECE	-0,64%	-0,60%	-0,27%	0,12%	-0,11%	-0,49%	0,22%	-5,05%	1,32%	1,37%	***-0,04%***

Note: Values in Italics are not statistically significant different from zero at the 95% level; median estimates of boostrapped Generalized IRFs, value for quarter 8 (2-years)

Results

- No spillover from non-Euro Area
- in the Euro Area fiscal consolidation generates spillovers and crowding-in of private investment and consumption
- All spillovers **from aggregate Euro Area** fiscal stance are crowding in investment
  - France and Italy are weaker than the rest
  - France is financial hub of Euro Area
  - Italy's interest rates do not respond to EA and domestic borrowing (high debt level)

Results

- Nearly all spillover coefficients are positive for Italy
  - **Fiscal consolidation in Italy generates less borrowing from other member states**
- A fiscal consolidation at European level is conductive to a low interest rates environment
  - strongly beneficial for the Italian budget, given that interest rate expenditure amounts at nearly 5% of GDP (the highest level among major countries).

Results

- Given the past track record, Italian budget policy faces a reputational problem
  - credibility premia can be extracted in the case of common fiscal consolidation.
  - Thus, a national orientation towards fiscal expansion is not in the interest of Italy
- **A Fiscal Union is in the interest of all member states of the Union in order to manage the spillover effects from budget policies**

Fiscal Union

- Define aggregate fiscal policy stance in accordance with business cycle
- Fine-tune domestic divergences by regional budgets and investment plans
- Implement by European finance minister
- Prevent national governments from damaging the interests of all Europeans
  - Negative externalities

Union Budget and Transfer Union

- No blanc cheque
- Fiscal federalism and public goods
  - US versus German model
- European Budget is less than 1% of GDP
  - 56% spent in Euro Area
- Transfer Union is politically unsustainable

Professor Stefan Collignon

Table 3. European Union Budget

2016

EXPENDITURE	mln €	% of total	% of GNI
SMART AND INCLUSIVE GROWTH	56,265.0	41.2%	0.38%
COMPETITIVENESS FOR GROWTH AND JOBS	*18,461.2*	*13.5%*	*0.12%*
ECONOMIC, SOCIAL AND TERRITORIAL COHESION	*37,803.8*	*27.7%*	*0.26%*
SUSTAINABLE GROWTH: NATURAL RESOURCES	57,411.8	42.1%	0.39%
SECURITY AND CITIZENSHIP	3,077.3	2.3%	0.02%
GLOBAL EUROPE	10,277.1	7.5%	0.07%
ADMINISTRATION	9,324.2	6.8%	0.06%
TOTAL EXPENDITURE	136,416.4	100.0%	0.92%

REVENUE	mln €	% of total	% of GNI
VAT-BASED OWN RESOURCE	15,895.1	11.0%	0.11%
GNI-BASED OWN RESOURCE	95,578.4	66.3%	0.65%
UK CORRECTION	626.1	0.4%	0.00%
REBATES	-19.5	0.0%	0.00%
TOTAL NATIONAL CONTRIBUTION	112,080.2	77.8%	0.76%
TRADITIONAL OWN RESOURCES (TOR)	20,094.1	13.9%	0.14%
SUGAR LEVIES (100%)	*165.8*	0.1%	0.00%
CUSTOMS DUTIES (100%)	*24,951.9*	17.3%	0.17%
TOR COLLECTION COSTS	*-5,023.5*	-3.5%	-0.03%
TOTAL OWN RESOURCES	132,174.3	91.7%	0.89%
SURPLUS FROM PREVIOUS YEAR	10,565.8	7.3%	0.07%
OTHER REVENUE	1,349.1	0.9%	0.01%
TOTAL REVENUE	144,089.2	100.0%	0.97%
GROSS NATIONAL INCOME (GNI)	14,790,681		

Table 4. Transfers through the European Union Budget

	Exp. Mln €	Transfers Mln €	Rank	Exp. % of GNI	Transfers % of GNI	Rank	Exp. per person	Transfers per person	Rank
EU-28	117,875	0.00		0.80%	0.00%		230.5	0.0	
Euro Area	77,180	-14,342		0.72%	-0.13%		226.8	-42.1	
Non - EA	40,695	14,342		1.01%	0.36%		237.9	83.9	
Net Contributors									
France	11,275	-9,216	-2	0.50%	-0.41%	-1	168.6	-137.8	-1
Belgium	7,333	-1,534	-4	1.74%	-0.36%	-2	649.2	-135.8	-2
Germany	10,082	-10,988	-1	0.32%	-0.34%	-3	122.2	-133.2	-3
Austria	1,939	-968	-5	0.56%	-0.28%	-4	222.0	-110.7	-4
Finland	1,530	-424	-6	0.71%	-0.20%	-5	278.6	-77.2	-5
Italy	11,592	-3,207	-3	0.69%	-0.19%	-6	191.2	-52.9	-6
Netherlands	2,289	-309	-7	0.33%	-0.04%	-7	134.4	-18.1	-7
Net Recipients									
Luxembourg	1,788	7	12	5.08%	0.02%	12	3060.4	12.8	12
Cyprus	185	21	11	1.06%	0.12%	10	217.3	24.9	11
Spain	11,593	1,678	4	1.04%	0.15%	9	249.6	36.1	10
Ireland	2,038	181	8	0.93%	0.08%	11	435.0	38.7	9
Slovenia	545	180	9	1.39%	0.46%	8	263.9	87.3	8
Portugal	3,384	1,717	3	1.87%	0.95%	7	327.8	166.3	7
Latvia	734	504	6	2.92%	2.01%	5	374.7	257.4	6
Malta	208	119	10	2.22%	1.27%	6	474.3	271.5	5
Estonia	674	479	7	3.29%	2.34%	4	512.0	363.9	4
Slovakia	2,663	1,986	2	3.34%	2.49%	2	490.3	365.7	3
Greece	5,850	4,286	1	3.32%	2.43%	3	542.5	397.5	2
Lithuania	1,477	1,143	5	3.99%	3.09%	1	515.1	398.4	1
Net Contributors									
Denmark	1,431	-639	-1	0.50%	-0.22%	-2	249.8	-111.5	-1
UK	7,052	-6,272	-3	0.30%	-0.27%	-1	107.5	-95.7	-2
Sweden	1,712	-946	-2	0.36%	-0.20%	-3	172.5	-95.4	-3
Net Recipients									
Croatia	921	516	1	2.09%	1.17%	6	220.9	123.8	6
Poland	10,638	6,973	6	2.61%	1.71%	5	276.8	181.5	5
Bulgaria	2,345	1,946	2	5.00%	4.15%	1	329.0	273.1	4
Romania	7,360	5,962	5	4.47%	3.62%	2	373.5	302.6	3
Czech Rep.	4,690	3,222	3	2.86%	1.96%	4	443.9	304.9	2
Hungary	4,546	3,581	4	4.19%	3.30%	3	463.2	364.9	1

Conclusion

- European integration has generated enormous opportunities for its citizens
- Single market requires a single currency
- The management of the Euro economy is not optimal
- We need to create a better Europe, not destroy it
- The “smile of Italian families” can only be sustained in a strongly integrated Europe

Thank you !