

Europe in the Global Economy

ECONOMIC INTEGRATION IN THE EU

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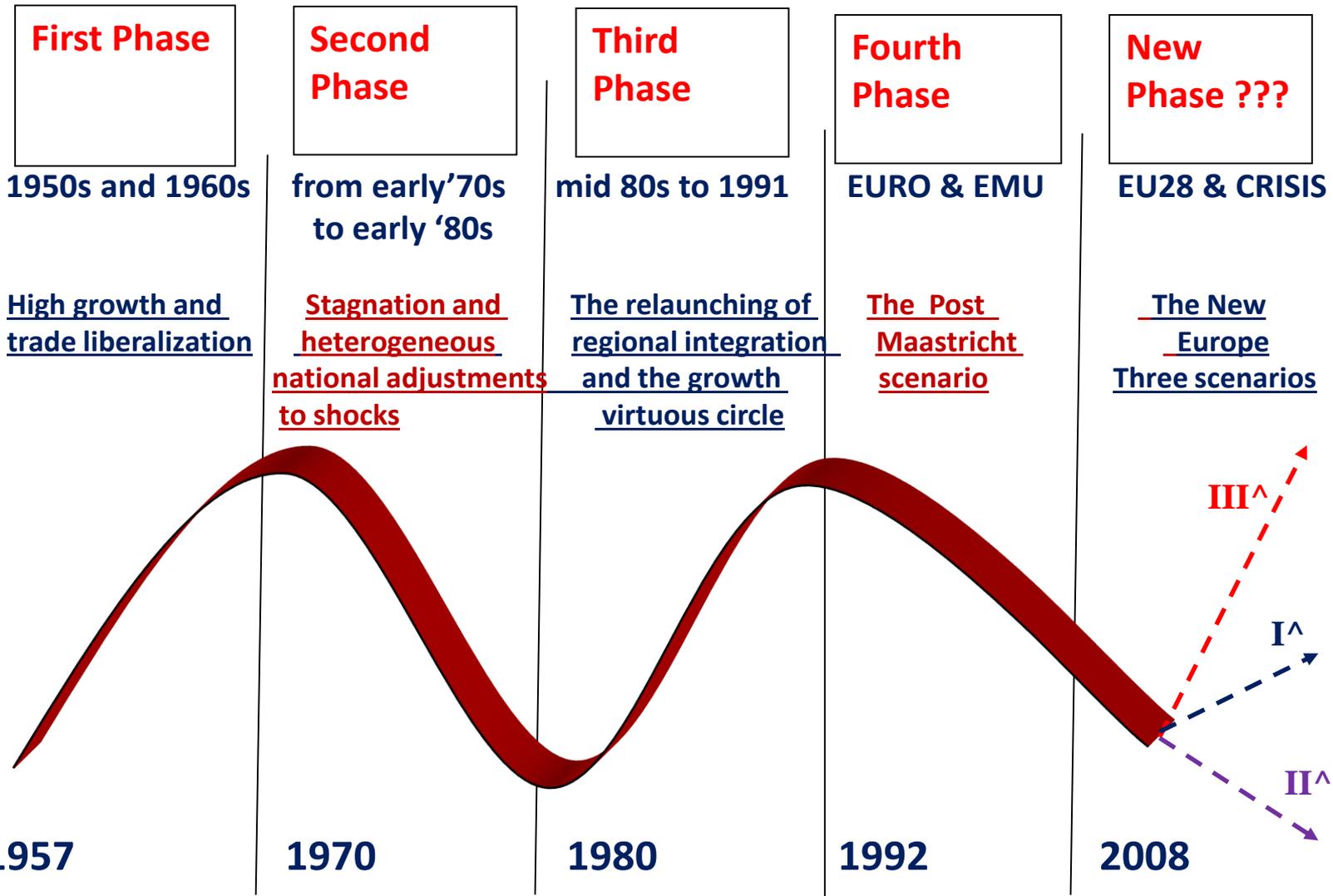
- Three different scenarios on the future integration of the EU:
 - ❖ *The 'small steps' scenario*
 - ❖ *An 'imploding fragmented EU' scenario*
 - ❖ *A 'more integrated EU' scenario*

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- Three different scenarios on the future integration of the EU:
 - ❖ *The 'small steps' scenario I[^]*
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EVOLUTION OF EUROPEAN INTEGRATION PROCESS

UPS and DOWNS



THE 'SMALL STEPS' SCENARIO: the optimistic dominant view

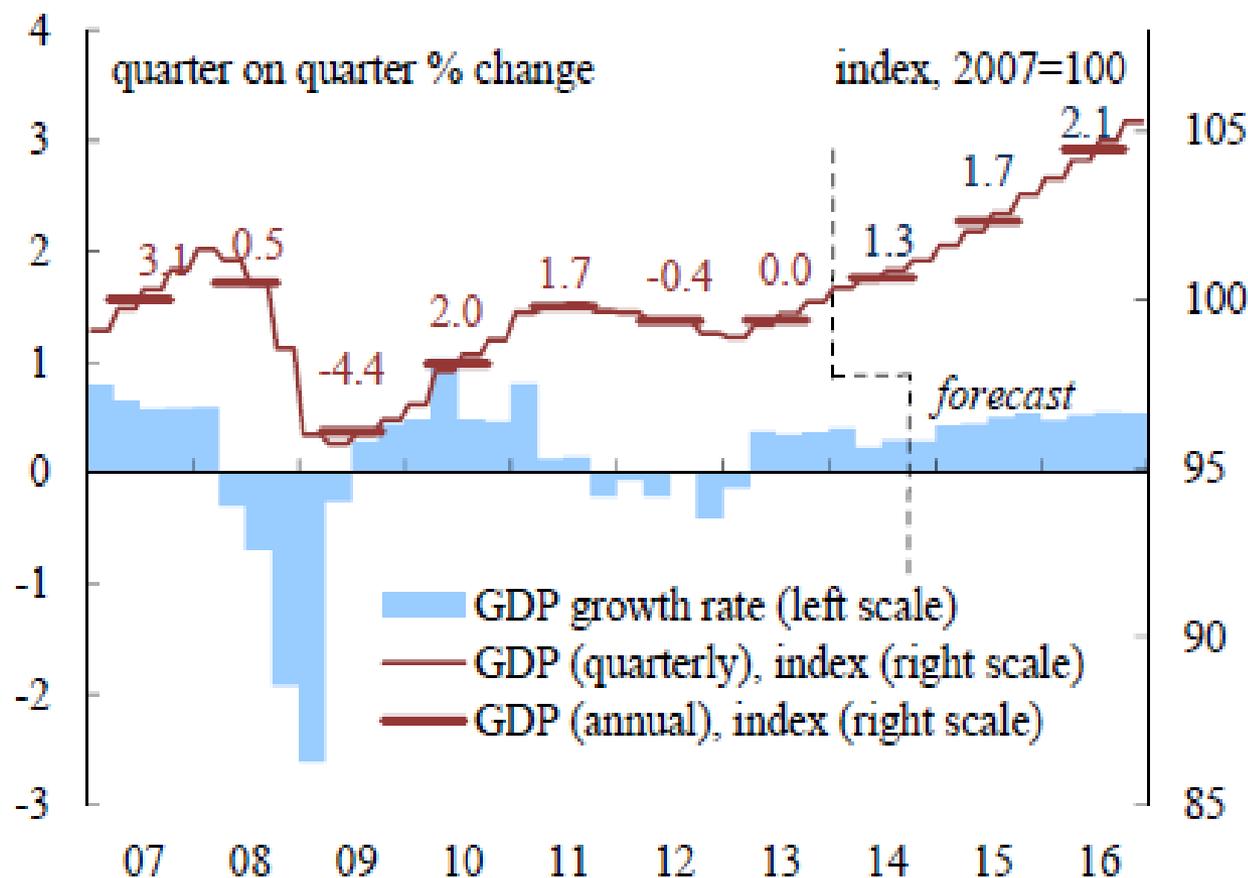
The policies so far adopted – fiscal austerity plus structural reforms - are positively working and they only need more time and flexibility to produce the expected results.

According to this view fiscal responsibility plus structural reforms plus a modest Juncker investment plan should improve competitiveness and confidence, leading to stronger growth

The optimistic reading is that the economic performances of high debt countries has in fact started to improve, and an effective adjustment process is under way.

EU growth is gradually improving

GDP growth in the EU

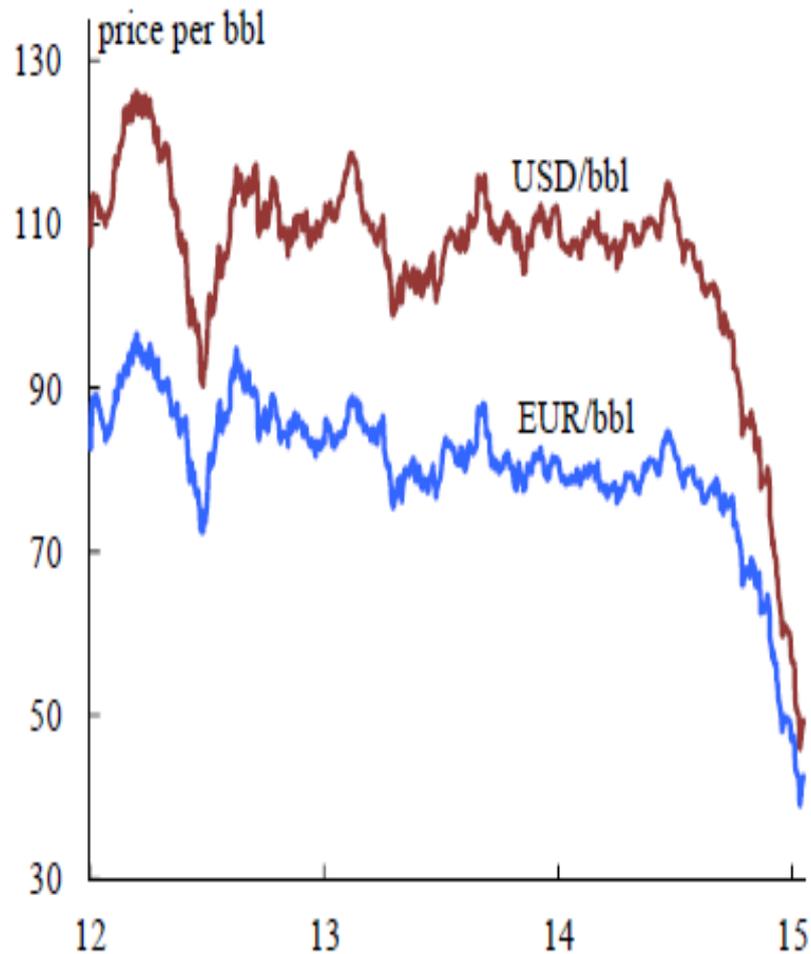


Figures above horizontal bars are annual growth rates.

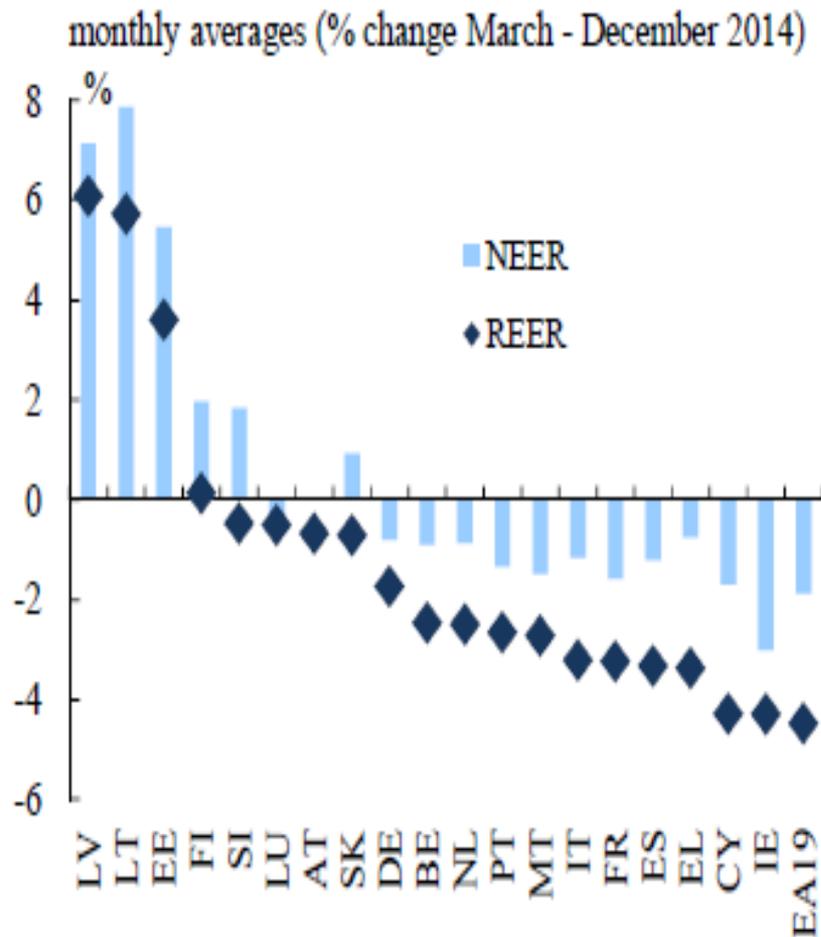
Steep fall in oil prices

Euro has depreciated against major peers

Brent oil spot prices (USD/€)



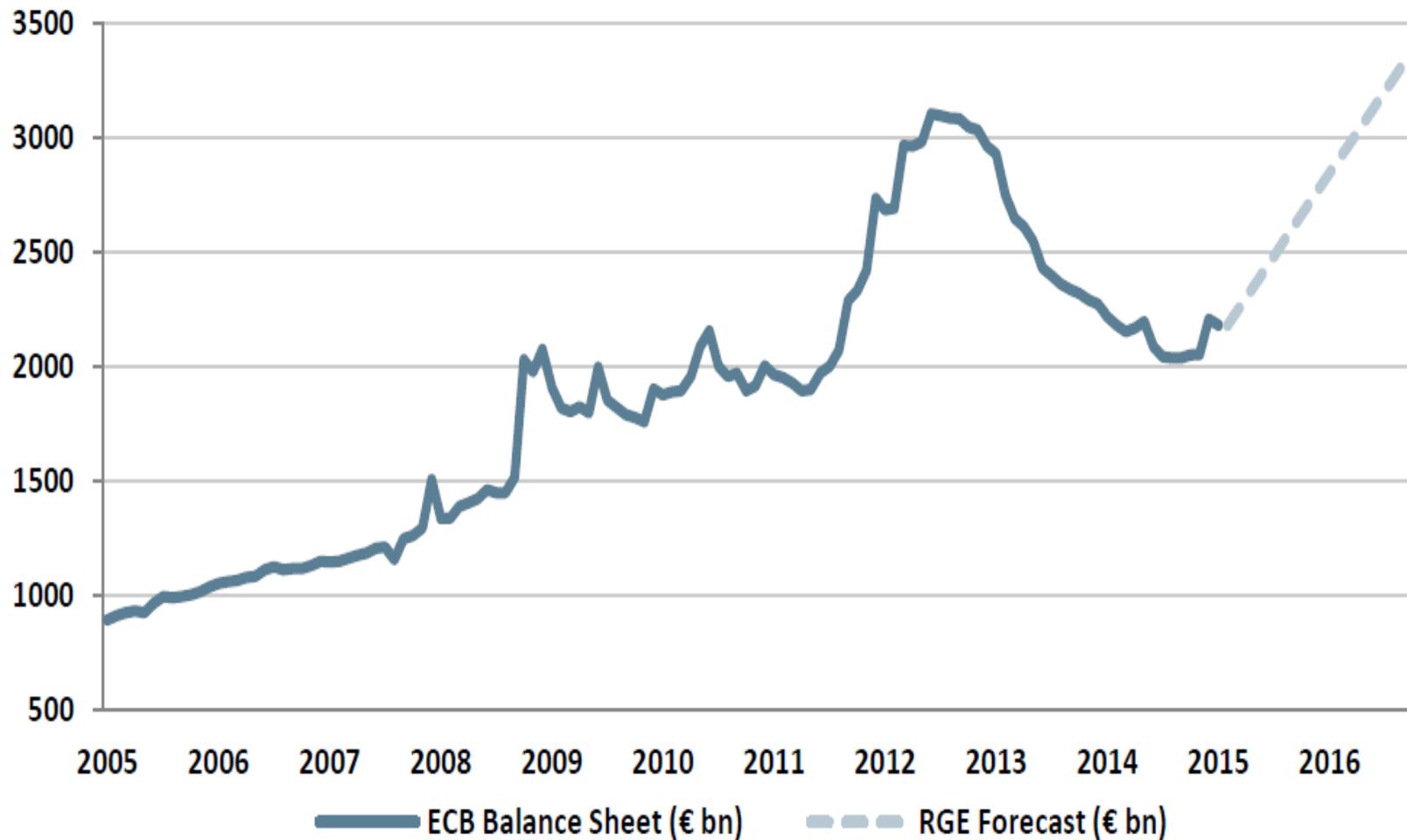
Real and nominal effective exchange rate



ECB QUANTITATIVE EASING

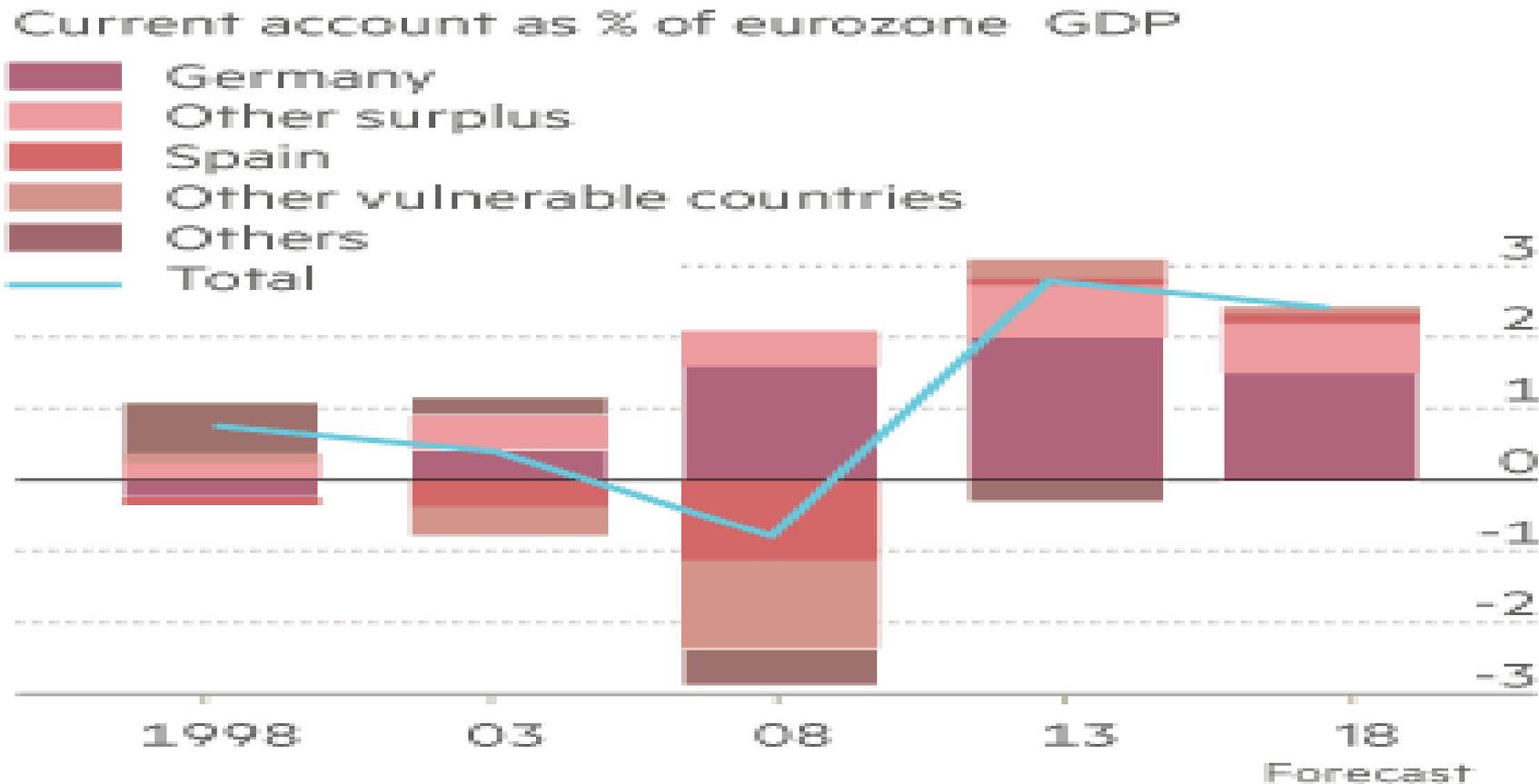
- At its January 22 meeting, the European Central Bank (ECB) announced new monetary stimulus measures that will add sovereign- and agency-debt purchases to its previously announced private-security purchases.
- The expanded program is scheduled to begin in March and run through September 2016, or until Eurozone inflation expectations rebound from near zero levels to the satisfaction of policymakers.
- In addition, the program will target total securities purchases of 60 billion euros per month.
- Taken together, the proposed volume and duration of securities purchases are more aggressive than markets had expected.

Figure 1: ECB's Balance Sheet to Undergo Considerable Expansion



Source: Haver, Roubini Global Economics

Eurozone imbalances and trade surplus

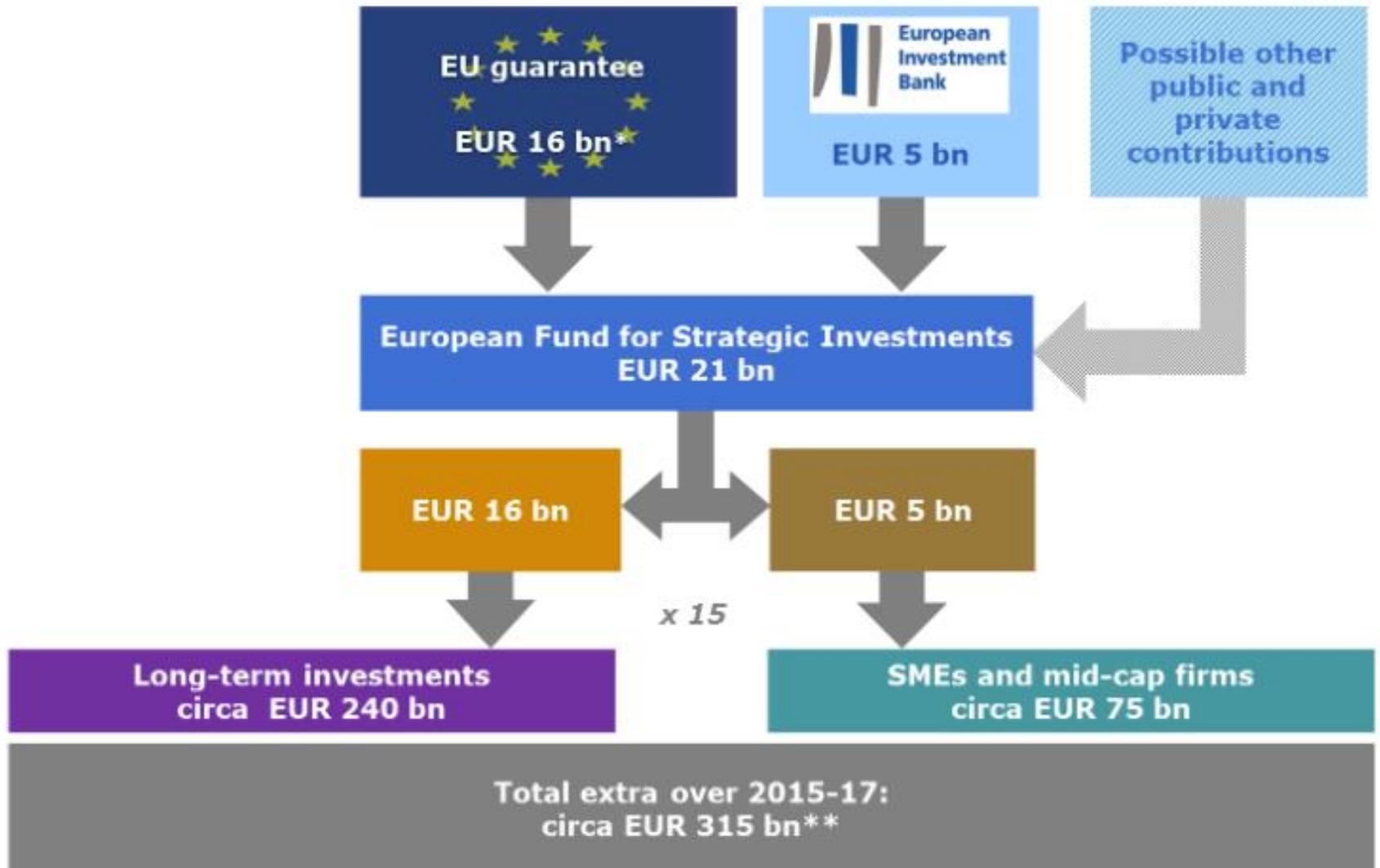


Source: IMF

FT

Over the last six years the biggest contribution to growth came from net exports. In 2008, the Eurozone had a deficit of around €85 billion (less than 1 per cent of GDP); in 2013 it had a surplus of close to 2.5 per cent of GDP.

A new European Fund for Strategic Investments (EFSI)



* 50% guarantee = EUR 8 bn from Connecting Europe Facility (3.3), Horizon 2020 (2.7) and budget margins (2)

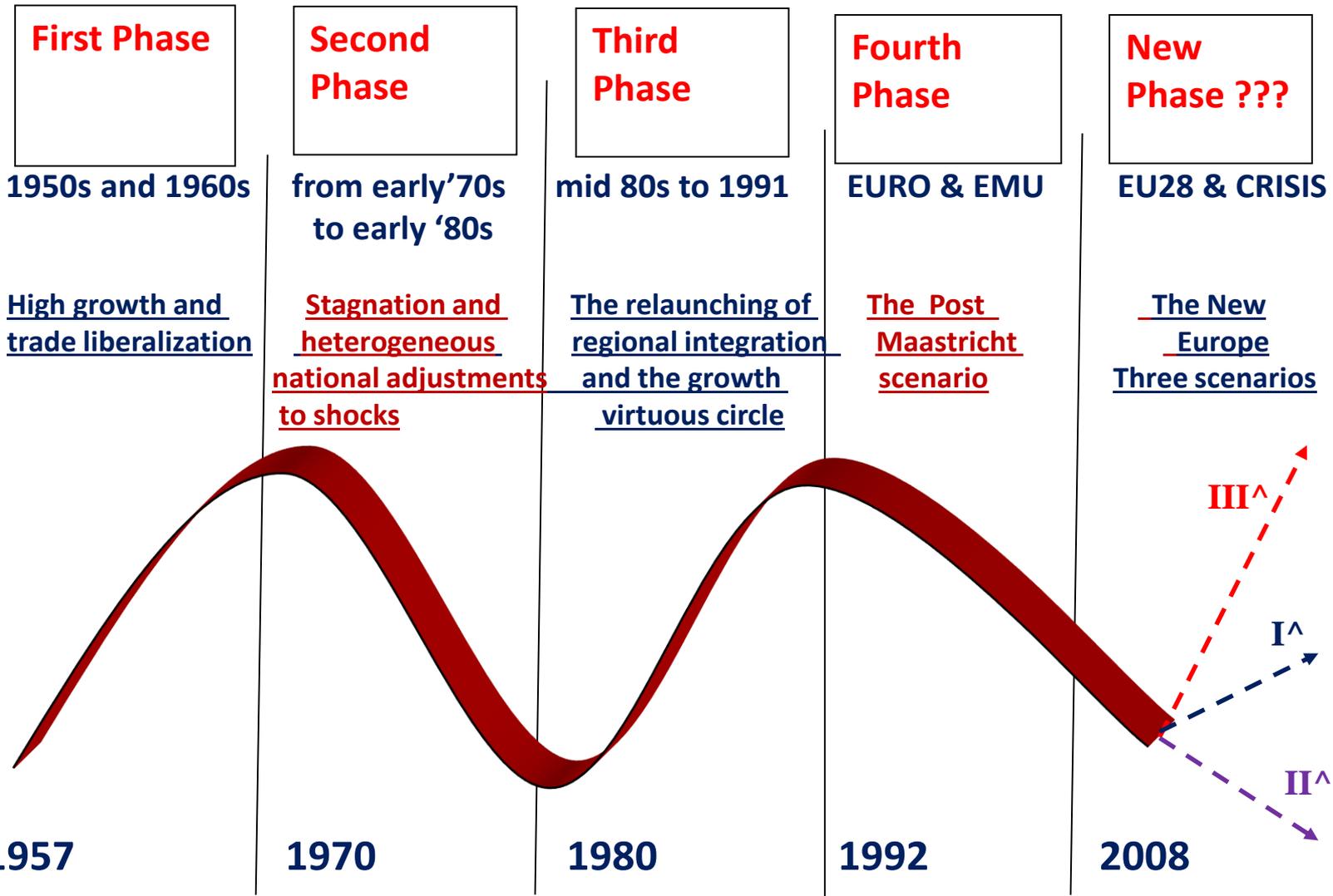
** Net of the initial EU contributions used as guarantee: EUR 307 bn

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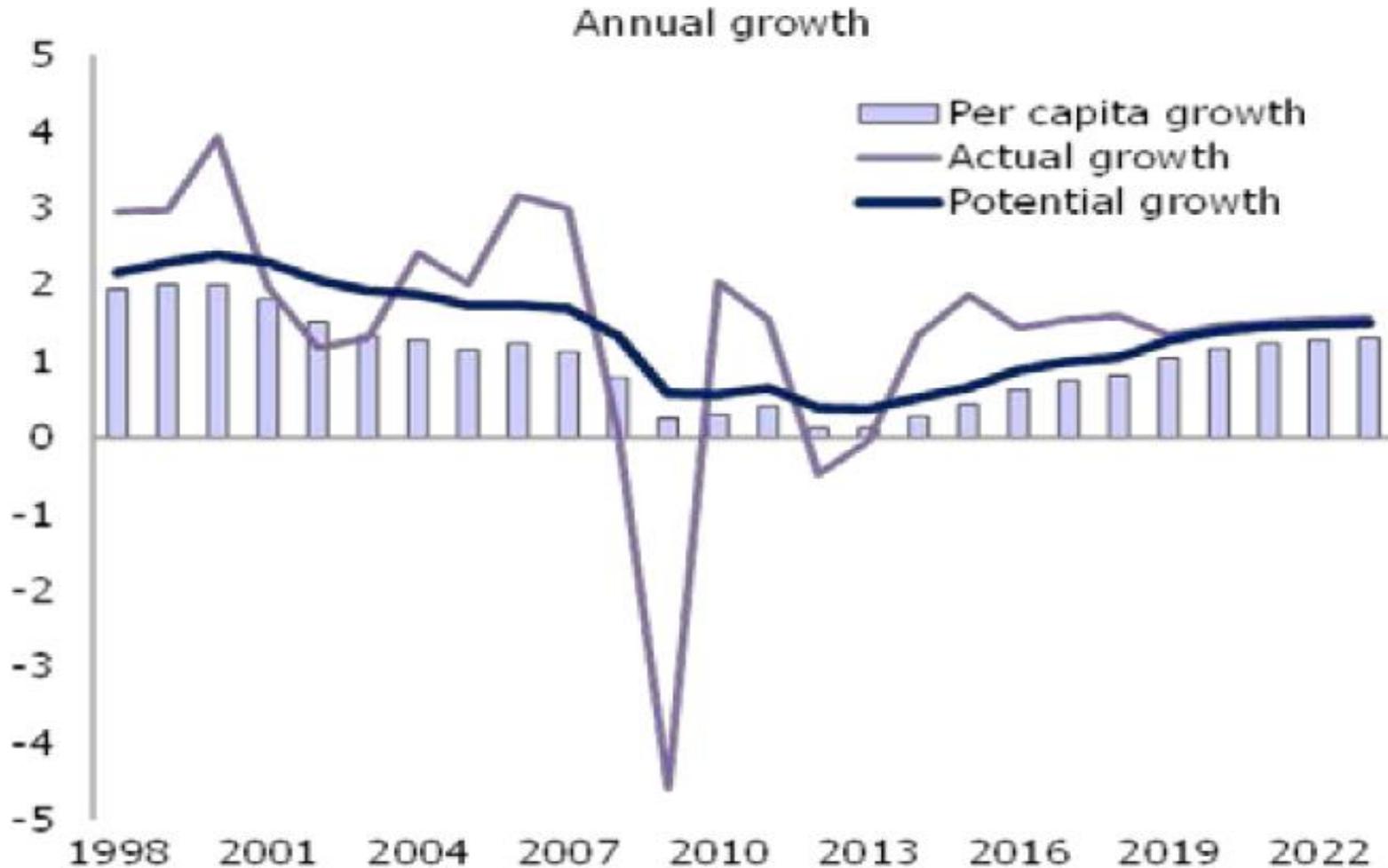
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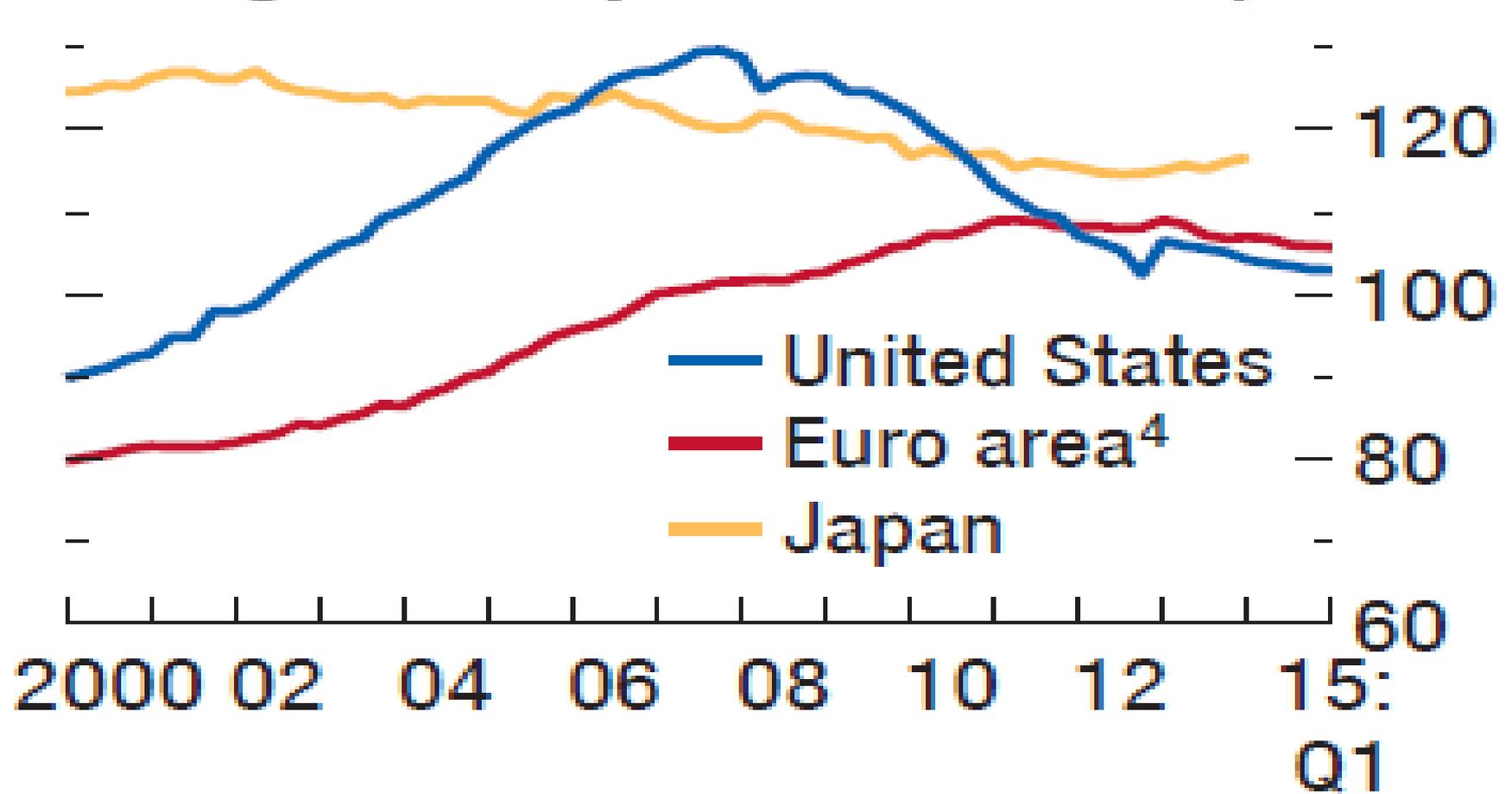


EUROZONE 'EXPORT LED' MODEL

the risk of long-term stagnation: GDP, Potential and per capita income growth



4. Household Debt (Percent of household gross disposable income)



Deflationary adjustment and the risk of socio-political revolts..

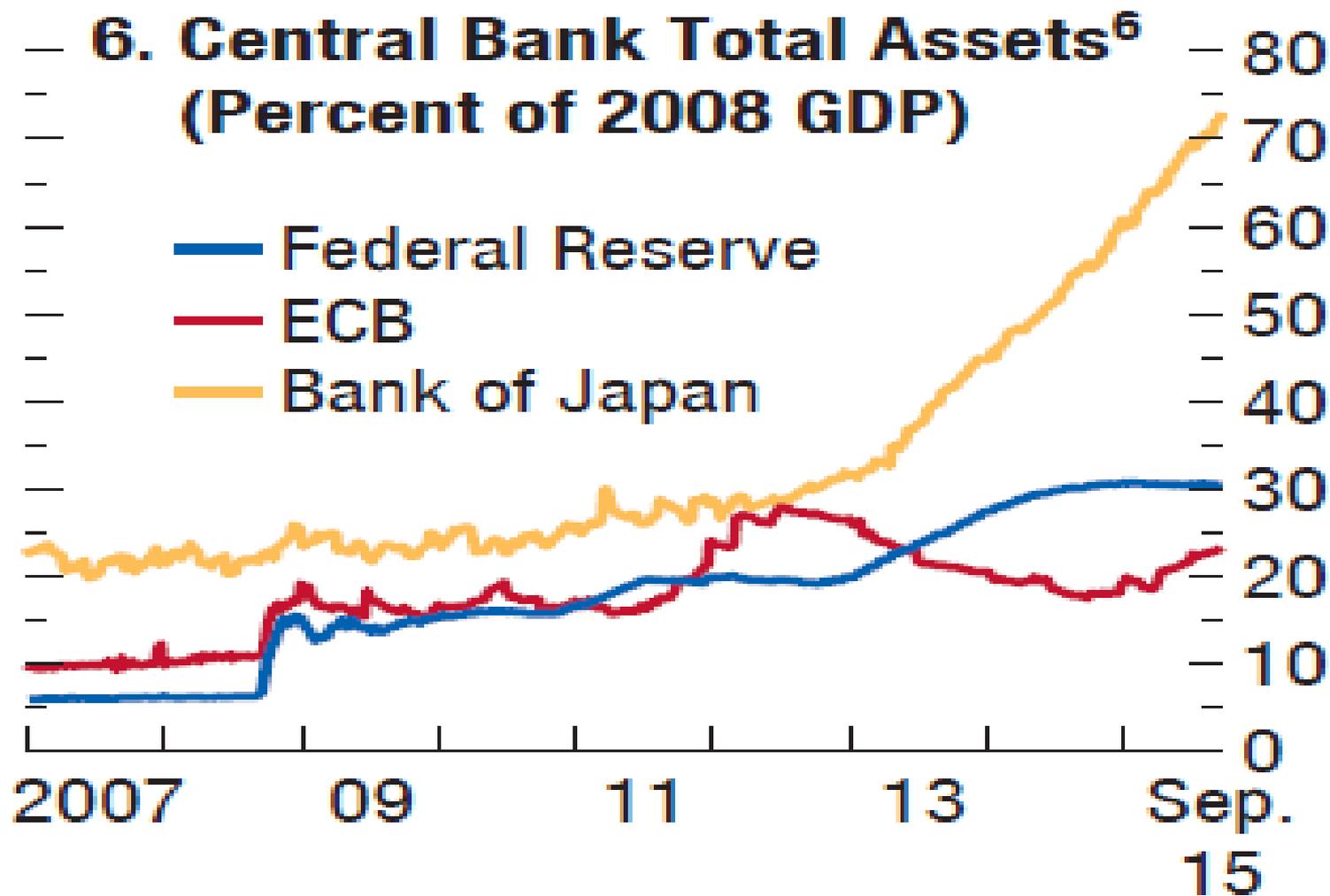
Given the very low growth and inflation of the Eurozone at the aggregate level, **it is very risky that real adjustment will take place mainly through deflation in the deficit countries,**

The asymmetry has already produced a deflationary bias in the eurozone as a whole. **As a consequence, growth has suffered and recession has hit all peripheral countries.**

Even if we assume optimistically that in the very long **run deflationary adjustments will work,** as long as stagnation endures, **the risk of populist revolts against EU-driven policies will increase in the mean time.**

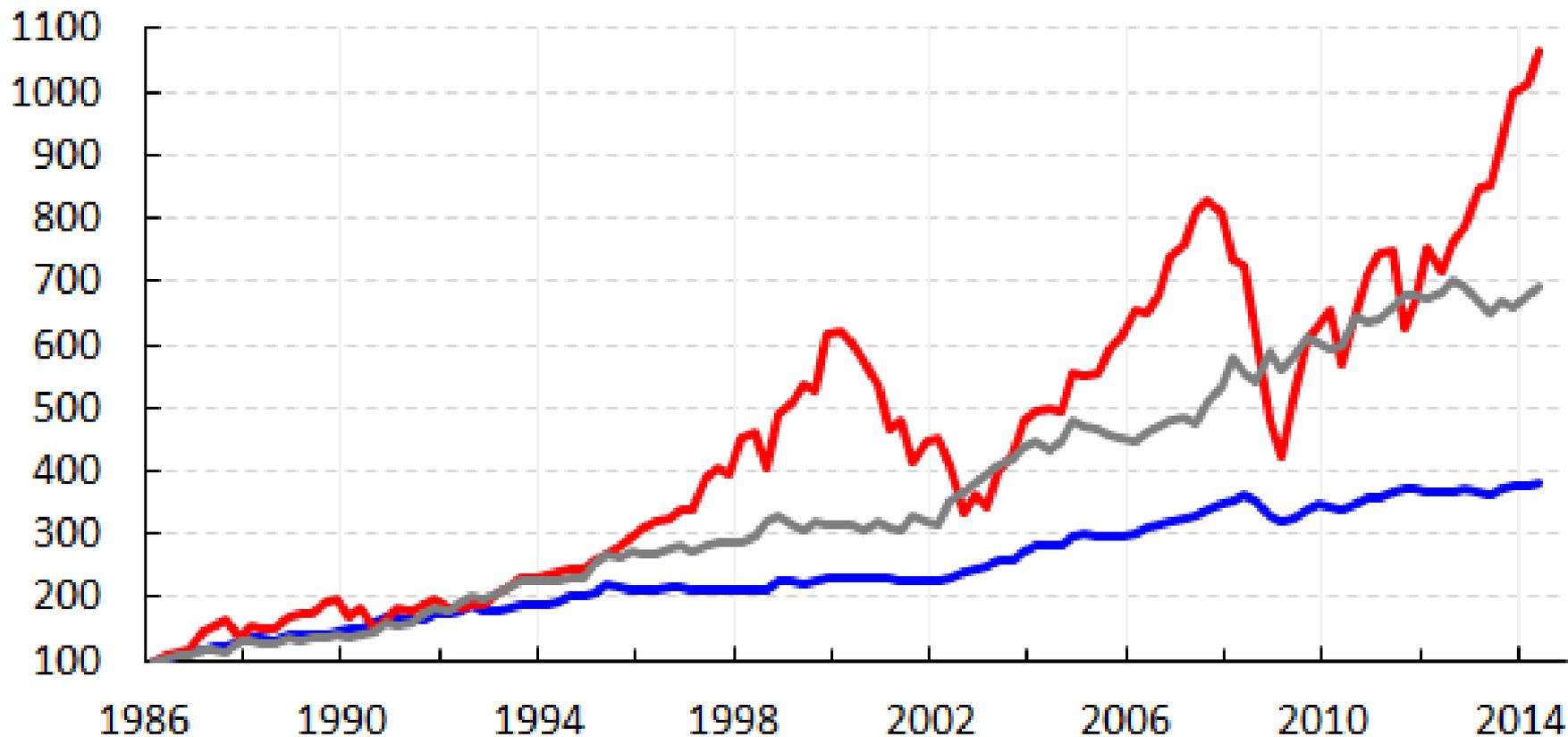
In many countries' of Europe there are anti Europe movements and forces, and many voters now associate structural reforms with slump, rising unemployment and social stress.

**Only heterodox monetary policies (QEs)
are working, more or less**



Global GDP and Asset Returns (Q1-1986=100)

- Nominal GDP (G7 Countries)
- Global Equities (MSCI World Index, total returns)
- Global Bonds (BofA Merrill Lynch Global Government Index, total returns)



Note: all variables are denominated in US dollars

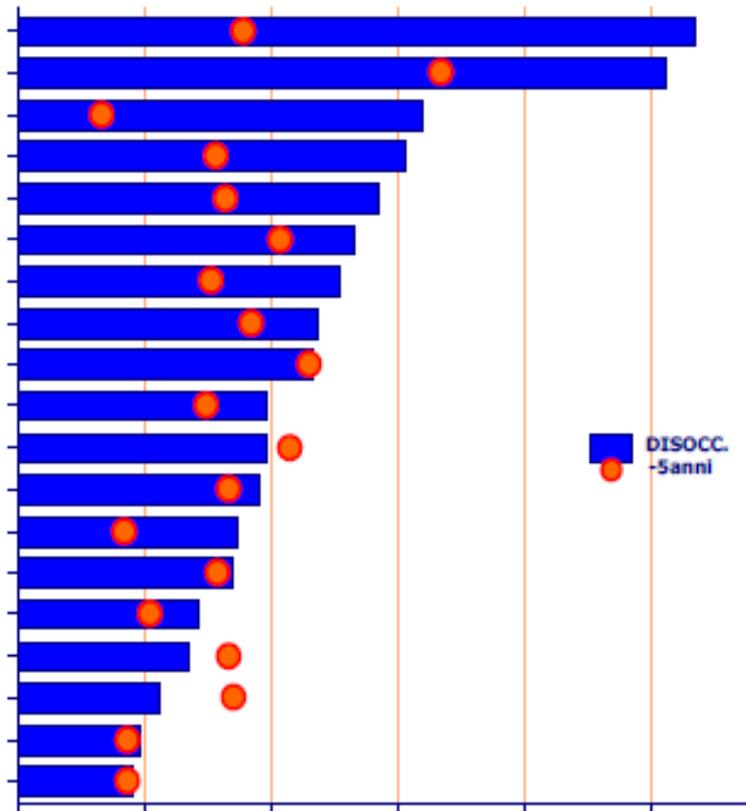
Sources: Haver Analytics, Merrill Lynch, MSCI

With over 12 percent, unemployment in the Euro Area is at the highest level ever since 1960. A whole generation – especially among young adults - will be lost.

... but the situation is dramatic in several countries.

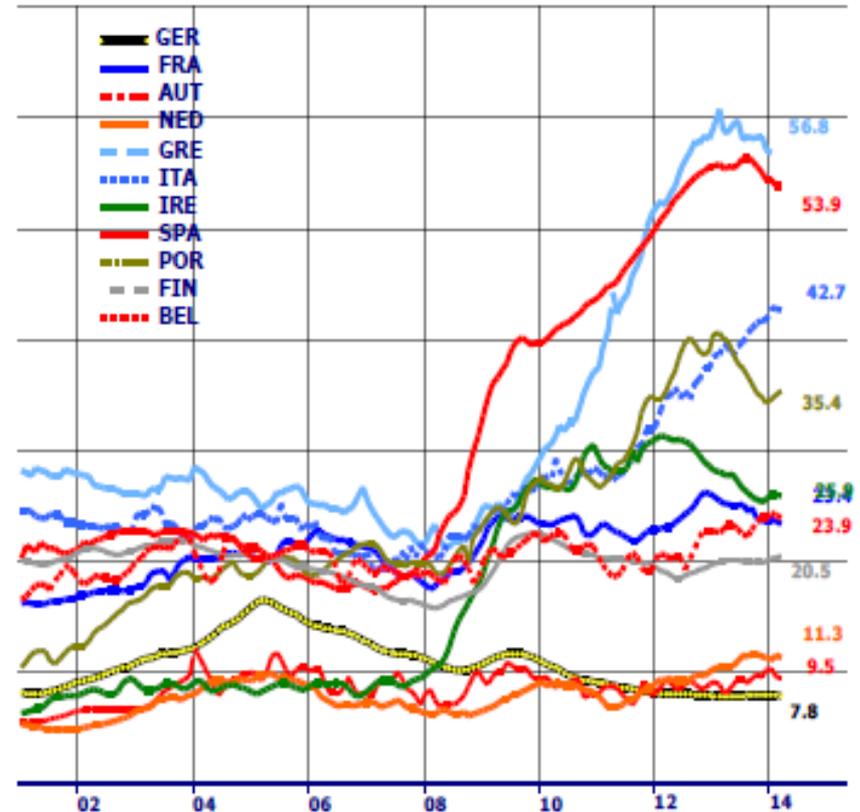
UNEMPLOYMENT RATE

Source: NATIONAL STATISTIC OFFICES

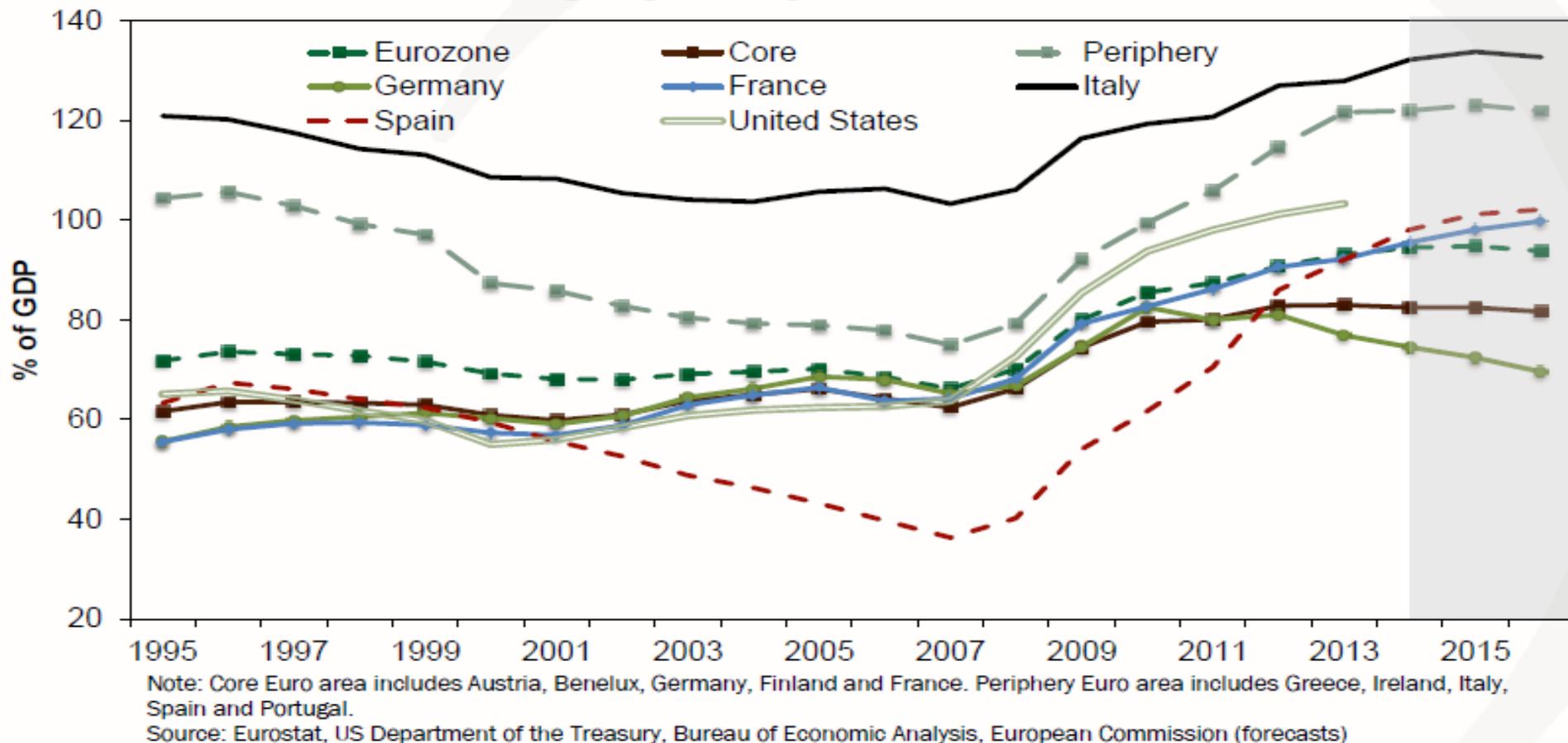


YOUTH UNEMPLOYMENT

Source EUROSTAT



Public debt deleveraging has yet to start



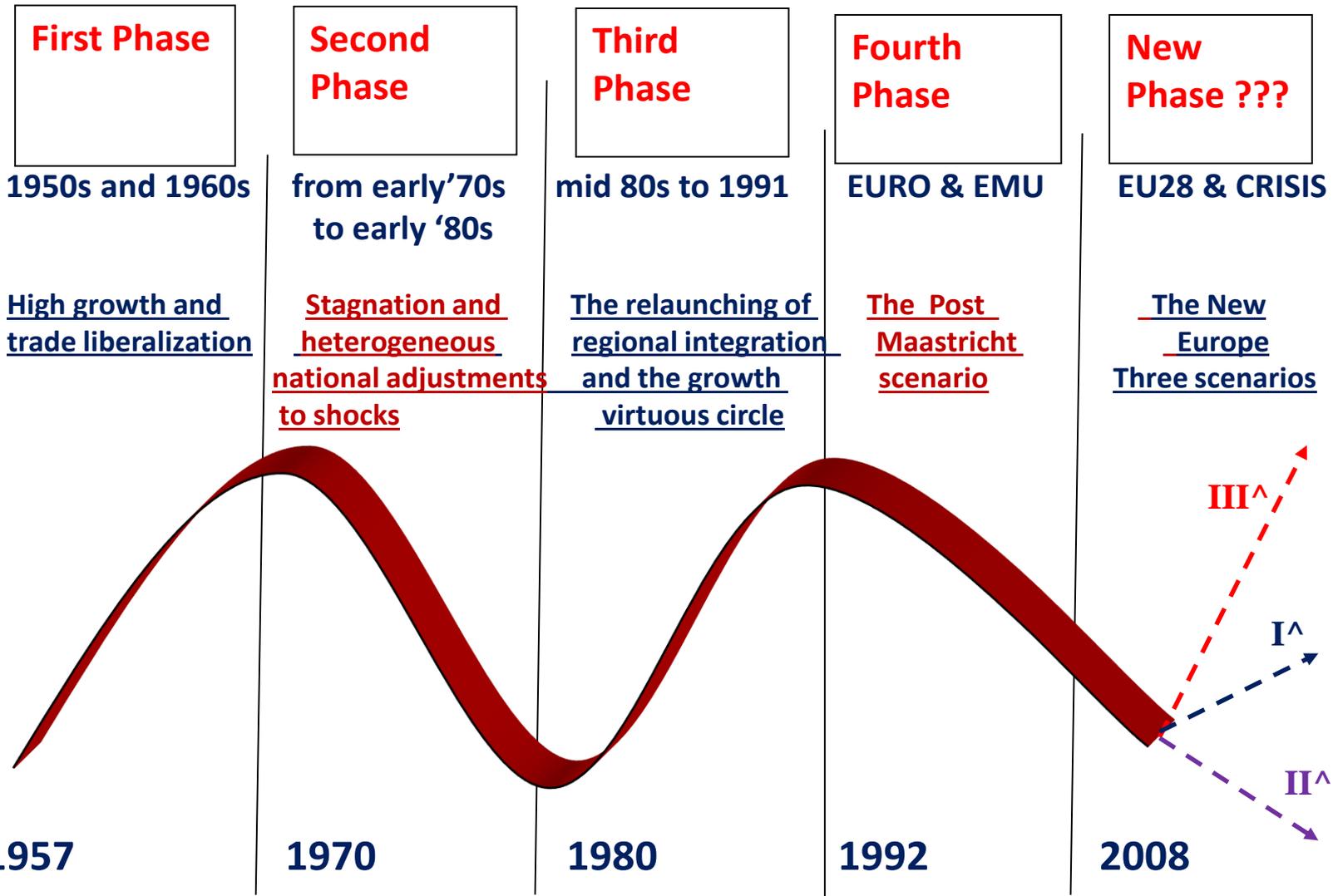
The austerity programs have not stopped the explosive growth of government debt to GDP ratios; sovereign debt in Greece is still over 170 percent of GDP; in Ireland, Italy and Portugal over 120 percent; in France and Spain rapidly approaching 100 percent.

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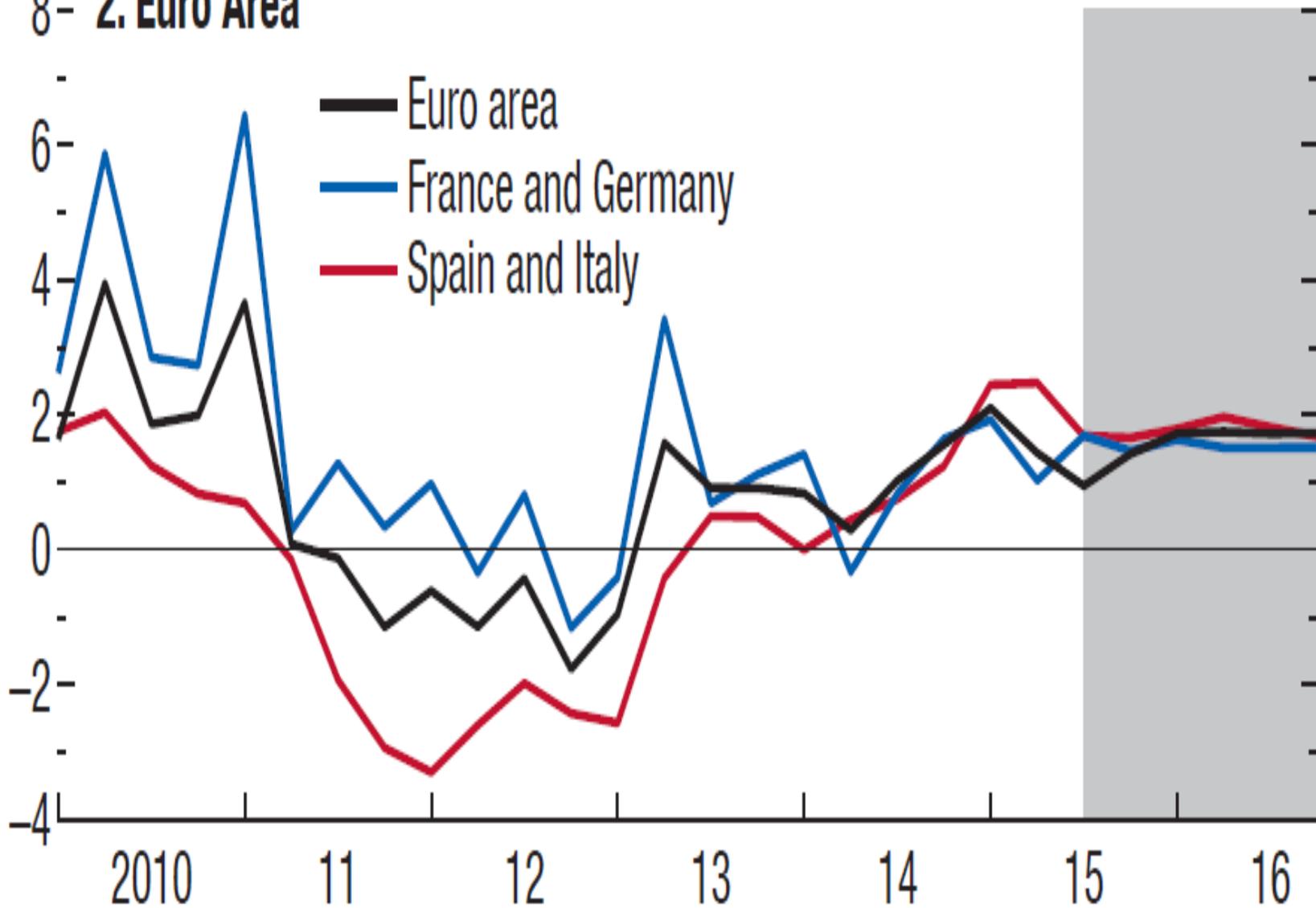
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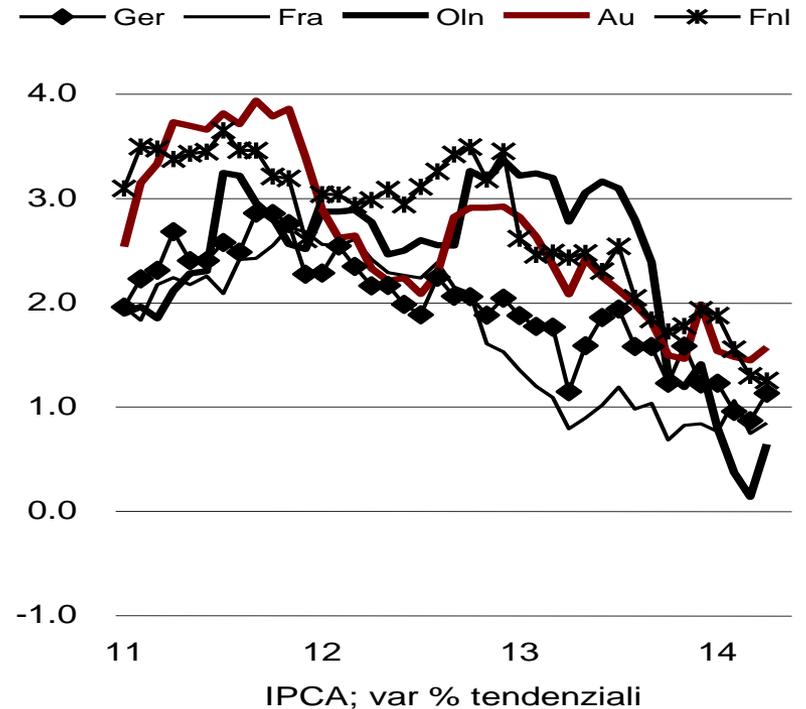
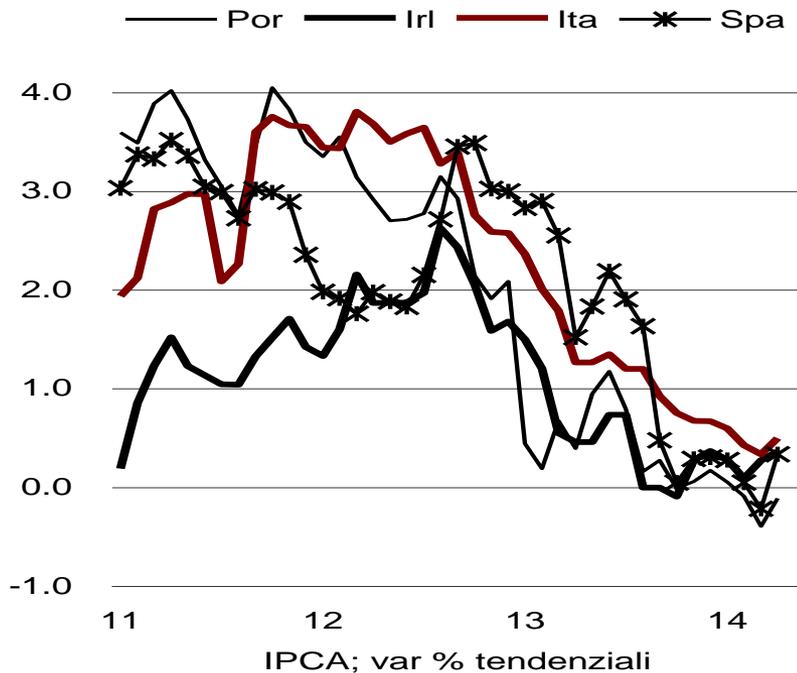
8- 2. Euro Area



Lowflation in the Eurozone

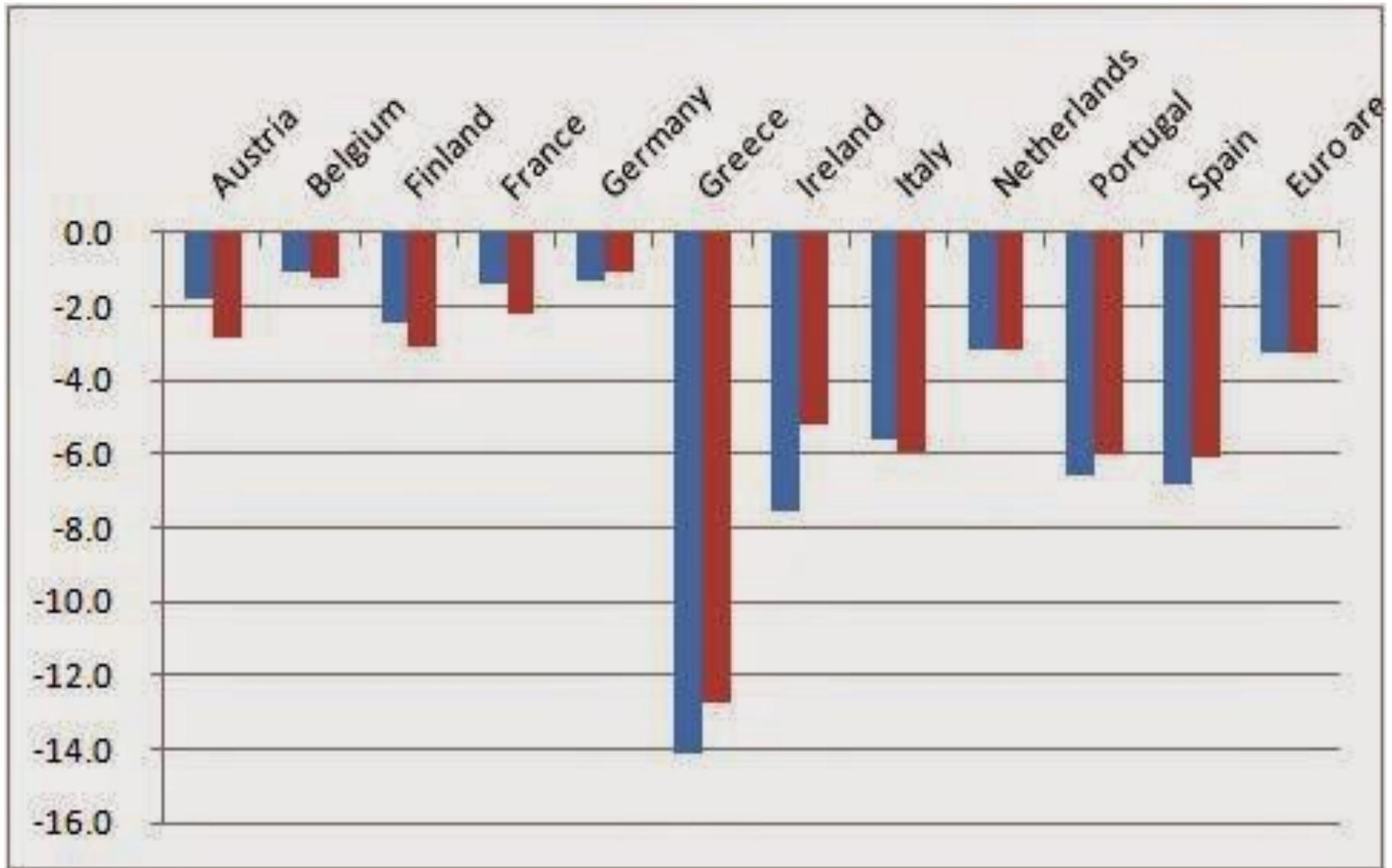
Inflation in the peripheral countries

Inflation in the core countries



The euro area is struggling with low inflation, which makes it more difficult to reduce debt levels. The recent ECB measures (QE) are important but will not be sufficient

Output Gaps across Eurozone Countries



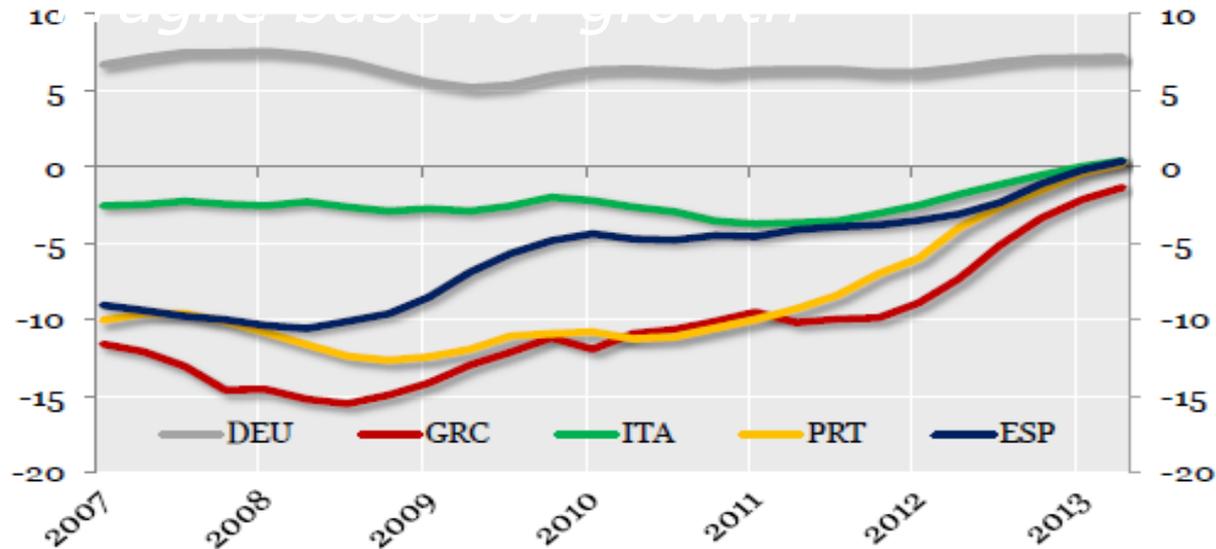
Source: OECD estimates

A MORE EFFECTIVE POLICY THERAPY

- ✓ Sluggish growth of the euro countries today is due first to a lack of aggregate demand
- ✓ There are also problems of structural supply-side factors, stemming from both the current prolonged recession and the difficult adjustment of many eurozone countries to the new global competitive environment.
- ✓ Escaping stagnation requires a balanced policy package that can simultaneously deal with both weak aggregate demand and supply weaknesses.
- ✓ These policies should be implemented at the Eurozone level ,as a whole, rather than at only national level as has been done in the past

The adjustment in the Eurozone is still asymmetric

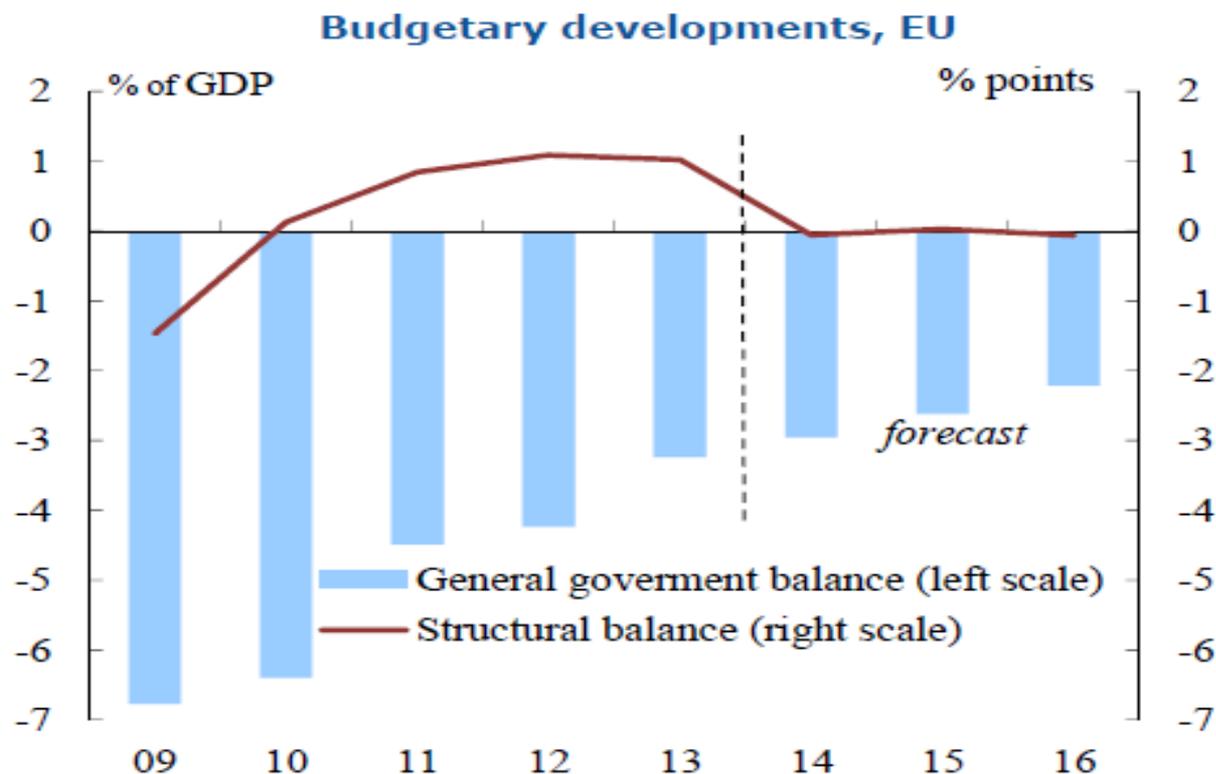
Current account balance/GDP
Percent, 4-quarter moving average



Source: OECD National Accounts database.

These adjustment processes were based on strong internal devaluation, that were usually obtained through high levels of unemployment and wage plus internal demand compression, while increases in productivity would have required organizational and process innovations.

The fiscal stance in the EU is now neutral



For a more expansionary fiscal policy at the Eurozone level, symmetrical adjustment mechanisms are needed to impose on both surplus (primarily Germany) and deficit countries. Large trade surpluses still place large obstacles in the way of needed adjustments between member states, even more so when interest rates are close to zero

What can be done for growth?

accelerating the Internal Market Programme: market opening, notably in network services, may unleash strong investment (energy, consolidation in communication industry and transport, etc.)

public investment – activating all EU instruments provided by the so-called Growth Compact: project bonds through the EIB and EIF to finance large infrastructural projects with EU value added;

private investment – two fundamental conditions: restoring normal lending conditions in the Eurozone financial markets; and, in addition, need to develop non-banking channels of long-term finance

FOR A SUSTAINABLE RECOVERY

Economic growth in the European countries will require substantial productivity advances

This in turn requires

- ❖ a more highly educated and skilled labor force,**
- ❖ a more efficient economic infrastructure, tangible and intangible,**
- ❖ a more welcoming environment for technological innovation and renewable energies**

Countercyclical fiscal interventions should be targeted to these new areas of growth by medium long run public and private investments

Investment is key for productivity growth and to strengthen demand

Growth rates in equipment investment in EA, selected member states, and US

	'09 vs '08	'13 vs '09	'15 vs '13
DE	-22.7	8.9	11.1
FR	-18.1	13.8	11.1
IT	-16.8	-6.8	11.9
UK	-20.3	-1.8	16.7
US	-19.0	33.8	13.7
EA-18	-19.1	3.0	11.4

Source: European Commission, Spring 2014 forecast

In the Eurozone, a prolonged negative output gap has affected potential GDP negatively, mainly by reducing investment. There has also been a continuous deterioration of investment dynamics, particularly in southern European countries, thus penalizing the long run growth perspective.

KEYNESIAN plus SCHUMPETERIAN POLICIES

To justify these interventions one could emphasize not only **the traditional Keynesian argument**, focussing on short run demand effects

but also

Long run Schumpeterian growth effects working primarily through the supply side of the economy.

A new sustainable medium long term growth cycle requires **both structural reforms and investments in the 'growth engines'**.

Sound theoretical arguments supporting this approach such as Endogenous Growth Theories (EGT)

A MORE INTEGRATED EU?

- ❑ To sum up it is very important that **more effective policies should be implemented at the Eurozone** level in the current phase
- ❑ But it is only **through further political and economic integration** that the EU will be able to provide appropriate responses to crises.
- ❑ Only after such a profound policy renewal **a further deepening and revision of the EU institutional structure could** take place.
- ❑ The major obstacle to move in the direction of greater cohesion is today the **mutual distrust between the North and South in** the Eurozone that has increased during these years of crisis.
- ❑ Therefore **we would need first to deliver new policies to exit from the crisis, only afterwards more integration.**

THE END

Thanks for your attention!