Managing Social Imbalances: competitiveness at the price of more working poverty?

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B.Cantillon, F. Vandenbroucke, *For Better For Worse, For Richer For Poorer. Labour market participation, social redistribution and income poverty in the EU*, OUP, forthcoming

- I. Marx, B. Nolan, In work poverty
- F. Vandenbroucke, V. Corluy, Household work intensity
- B. Cantillon, N. Van Mechelen, O. Pintelon, A. Vandenheede, Household work intensity and the poverty reduction capacity of social protection in the EU

-in work poverty : definitional issues

-has in work poverty increased ?

-understanding in work poverty

-broadening the scope : household work intensity

-the importance of the welfare state

-conclusions

Section 1: Definitional issues

Definition

- SPC « The working poor are those individuals who have mainly been employed during the reference year (either in wage and salary employment or as self-employed) and whose household equivalised disposable income is below 60% of national median equivalised income »
- OECD, academic literature employ similar definitions

(Marx, Nolan)

Definitional issues

- Mixing two levels of analysis (individual labour market status and household income adjusted for household size) inherently complicates interpretation
- Wide reference period – labour market and income position during the course of an entire year - equally complicates interpretation

(Marx, Nolan)

Section 2: Has in-work poverty increased?

Percentage of Those in Work At Risk of Poverty, EU 2000-2008

	% with annual equivalised incomes below 60% median		
	2000	2006	2008
Austria	6	6	6
Belgium	5	4	5
Denmark	3*	4	5
Germany	4	5	7
Spain	8	10	11
Finland	5	4	5
France	8	6	7
Greece	13	14	14
Hungary	6	7	5
Ireland	7	6	6
Italy	10	10	9
The Netherlands	6	4	5
Poland	11	13	12
Portugal	14	11	12
Sweden	5*	7	7
UK	6	8	9

Source: EU Social Inclusion Indicators website, I. Marx, B. Nolan, In work poverty in B. Cantillon and F. Vandenbroucke, For Better For Worse, OUP, forthcoming.

Section 3: Understanding in-work poverty

Income Poverty Risk for Low Paid Earners, EU 2007

Country	
Austria	14
Belgium	8
Germany	16
Denmark	19
Spain	15
Finland	14
Greece	13
Hungary	14
Ireland	5
Italy	22
The Netherlands	8
Norway	14
Poland	16
Portugal	19
Romania	17
Sweden	20
UK	11

Source: Analysis of EU-SILC microdata, (I. Marx, B. Nolan, In work poverty in B. Cantillon and F. Vandenbroucke, For Better For Worse, OUP, forthcoming)

Income Poverty Risk for Low Paid Earners, by household position, EU 2007

	single person	single parent	single earner couple	Dual earner, 1st earner	Dual earner, 2nd earner	other FTFY worker	Total
Austria	33	39	47	26	2	9	14
Belgium	14	12	28	11	2	6	8
Germany	33	36	36	22	3	8	16
Denmark	42	46	24	24	1	12	19
Spain	29	63	53	29	3	12	15
Finland	28	14	29	9	2	16	14
Greece	13	29	78	18	3	8	13
Hungary	41	57	40	7	2	7	14
Ireland	17	20	41	9	3	2	5
Italy	38	54	73	39	3	12	22
The Netherlands	2	59	39	9	2	6	8
Norway	30	31	37	15	3	5	14
Poland	28	27	46	33	3	13	16
Portugal	19	60	71	45	7	12	19
Romania	17	58	64	24	2	11	17
Sweden	43	15	43	25	4	10	20
UK	15	30	41	14	0	8	11

Source: Analysis of EU-SILC microdata, (I. Marx, B. Nolan, In work poverty in B. Cantillon and F. Vandenbroucke, For Better For Worse, OUP, forthcoming)

Understanding in-work poverty:

- The (vast) majority of relatively low-paid workers do not live in poor households
- Many relatively high up the income distribution as they tend to live in multi-earner households
- Low-paid jobs play – to an extent - a role in reducing the poverty risk in the double earner era

(I. Marx, B. Nolan, In work poverty in B. Cantillon and F. Vandenbroucke, For Better For Worse, OUP, forthcoming)

Understanding in-work poverty

- But low earnings severely problematic if there are no other incomes (earned or transfers); the poverty risk rises with the number of dependent persons, children or others
- The core of the working poor consists of sole earners with a family to support.
- Single parents are relatively overrepresented but the majority are two adult households with children

(I. Marx, B. Nolan, In work poverty in B. Cantillon and F. Vandenbroucke, For Better For Worse, OUP, forthcoming)

Understanding in-work poverty

- What matters is the *combined* labour market position of household members
- Hence, cross-country differences are not only reflective of the extent of low-paid empoyment or job precarity
- In-work poverty is equally if not more strongly associated with institutional factors affecting household employment patterns, e.g. child care cost and availability, breadwinner bias in labour market institutions
- ...and with *inadequacy of welfare state* (e.g. child benefits)

Section 4: Broadening the scope

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Household work intensity : the aggregate of individual work intensities in a household

0= no-one at active age worked during the preceding year

1=averyone at active age was full-time full-year employed

Section 4: Broadening the scope

-work intensity < 0,5

-work intensity > 0,5

Distribution of jobs ?

Pre transfer poverty ?

Welfare state ?

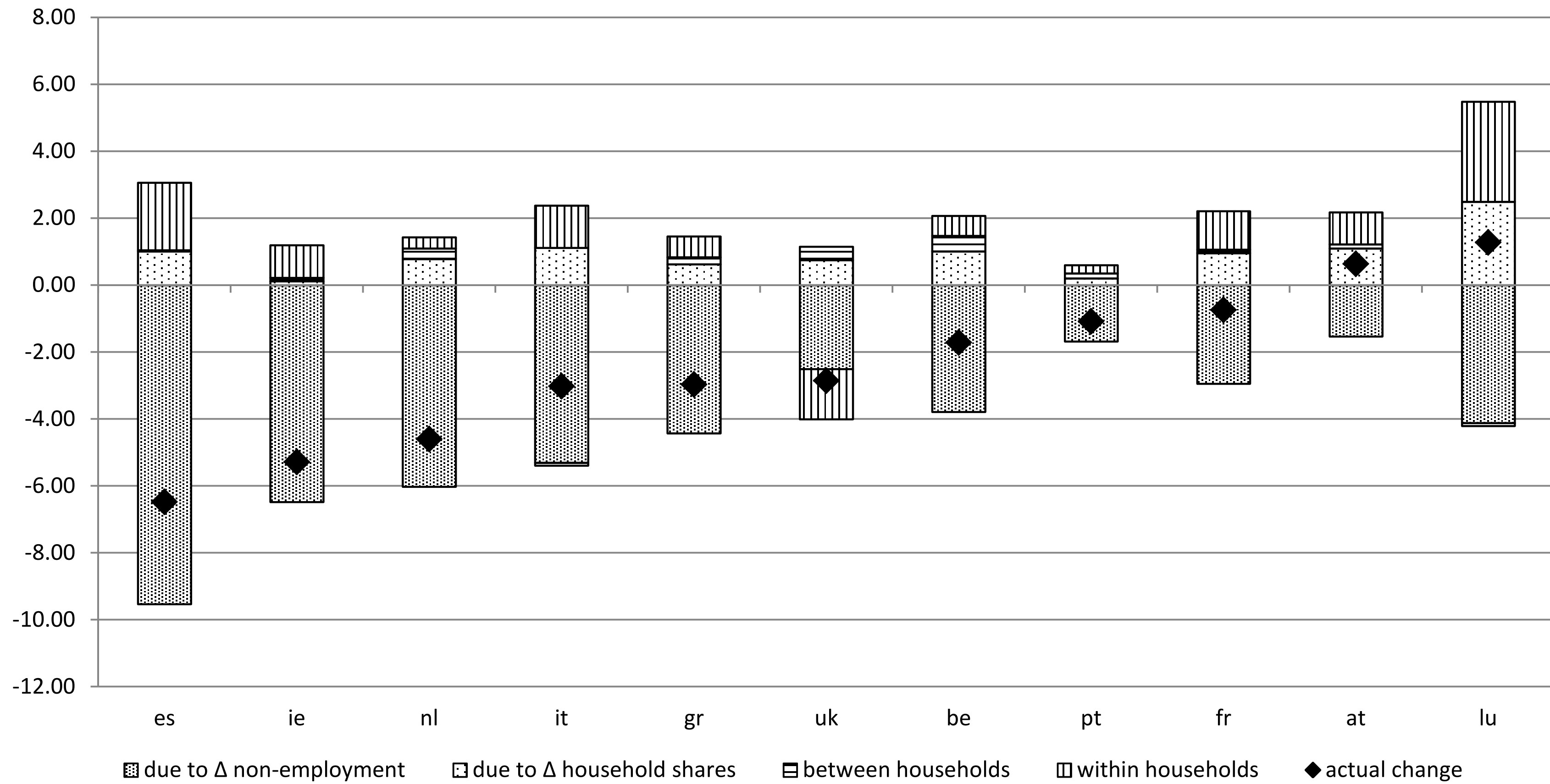
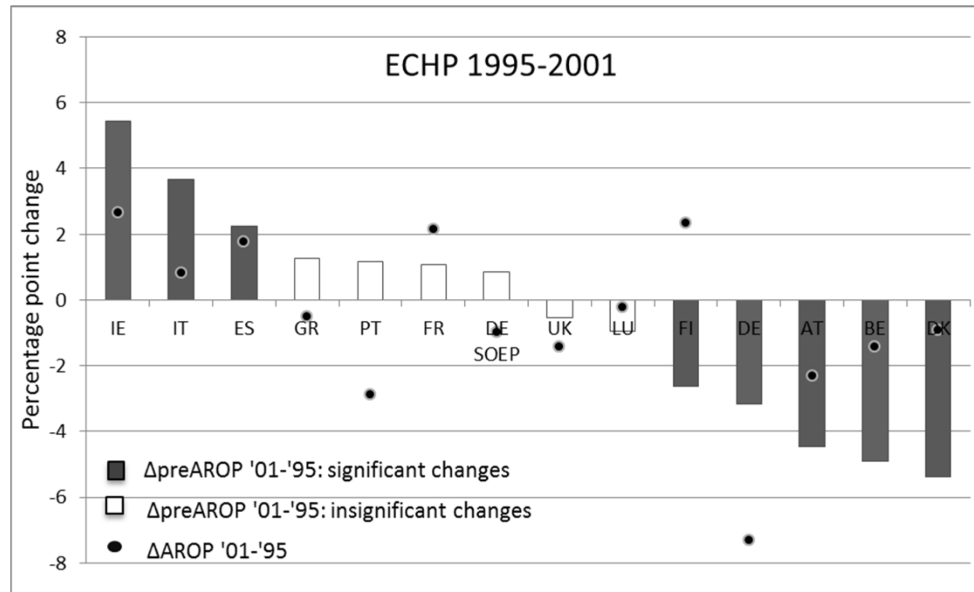
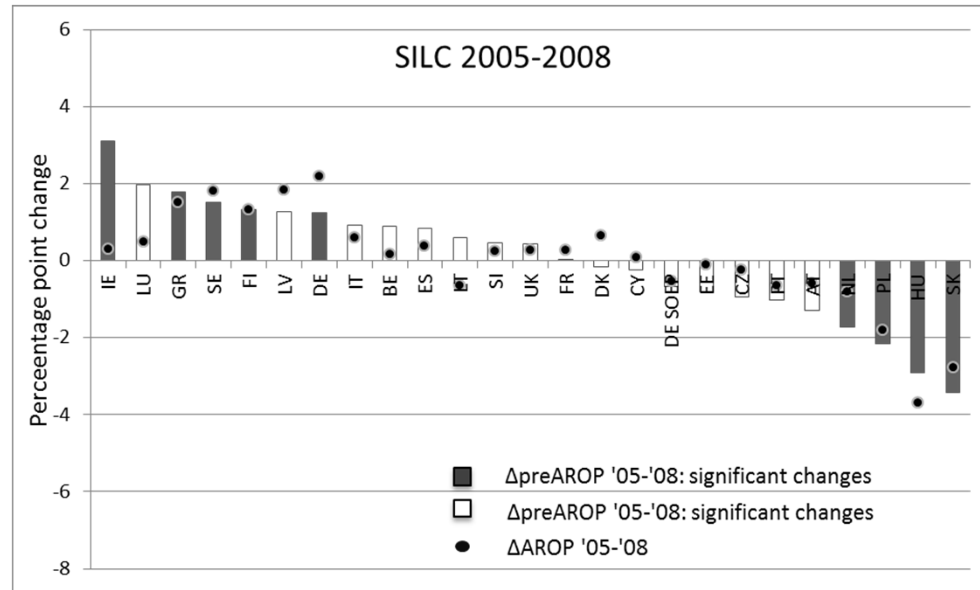

Decomposition of actual change hh joblessness, 1995 - 2008, EU11.
8.00
6.00
4.00
2.00
0.00
-2.00
-4.00
-6.00
-8.00
-10.00
-12.00
es
ie
nl
it
gr
uk
be
pt
fr
at
lu
due to Δ non-employment
due to Δ household shares
between households
within households
actual change

Figure 5-8. Evolution AROP rate (pre and post transfers) active age population (20-59 y.o.), work intensity ≥ 0.5 in the nineties



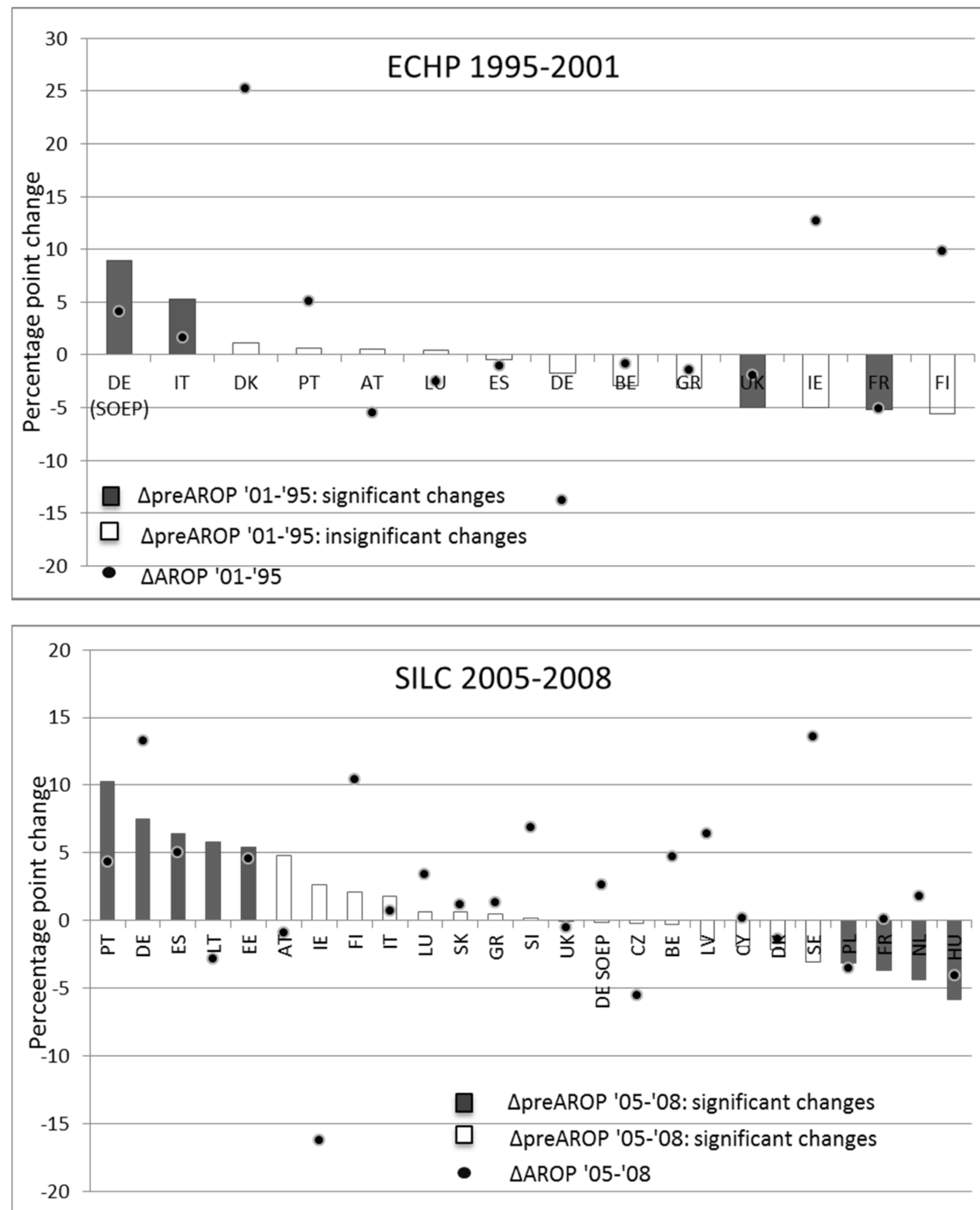
Source: own calculations ECHP (1995-2001) and SOEP

Figure 5-8. Evolution AROP rate (pre and post transfers) active age population (20-59 y.o.), work intensity ≥ 0.5 , 2005-2008



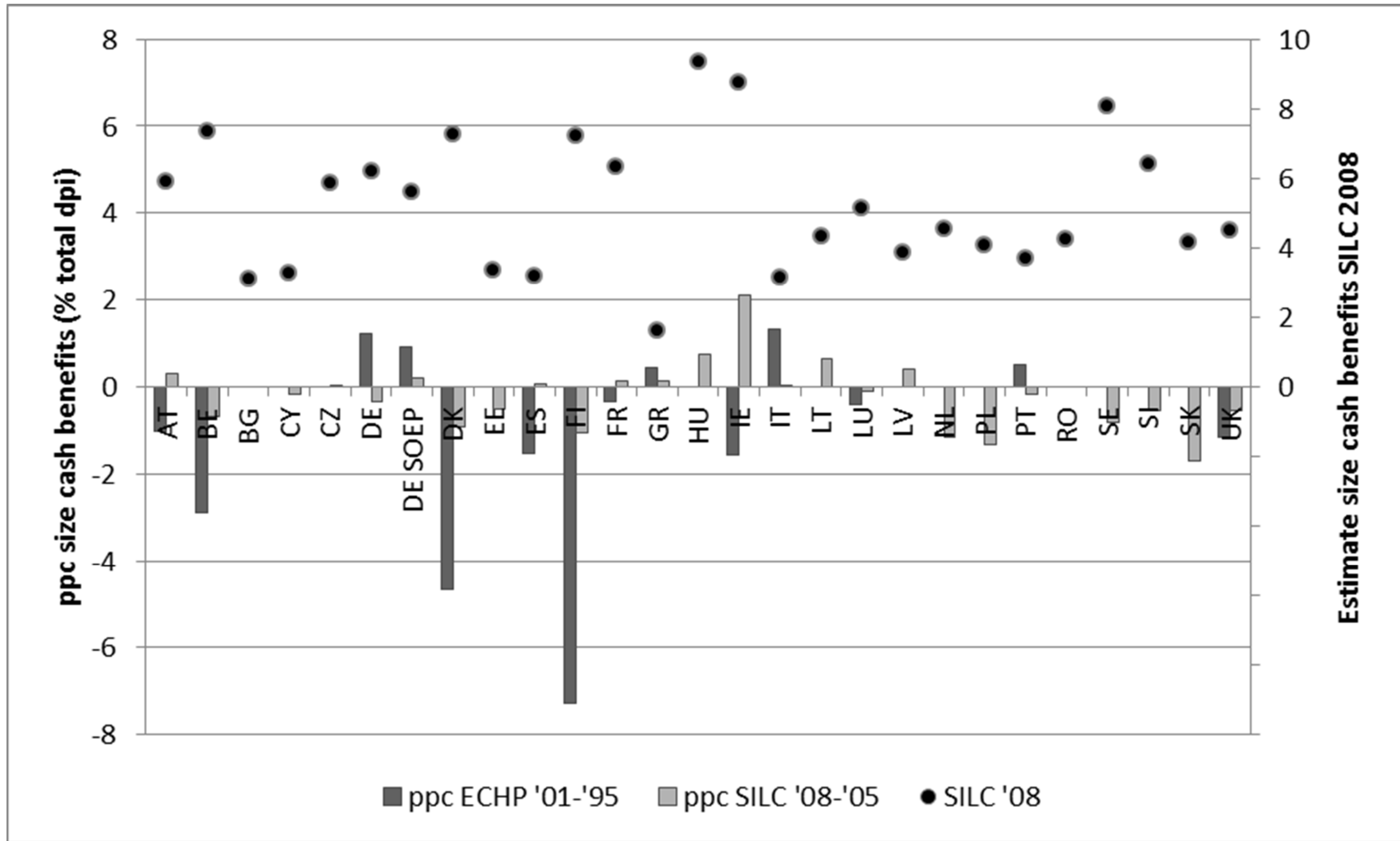
Source: own calculations EU-SILC (2005-2008) and SOEP

Figure 5-7. Evolution AROP rate (pre and post transfers) active age population (20-59 y.o.), work intensity < 0.5



Source: own calculations ECHP (1995-2001), EU-SILC (2005-2008) and SOEP

Figure 5-1. Evolution of size cash benefits (% of total disposable income, left axis) and SILC 2008 point estimate of cash benefits (right axis)



Note: ppc = percentage point change
Source: own calculations ECHP (1995-2001) and EU-SILC (2005-2008)

conclusion

- in the years before the crisis in work poverty was not on the rise in most countries, so probably no unavoidable trade off between in work poverty and competiviness
- in work poverty is strongly associated with low work intensity at the household level, linking in turn to tax and benefit system

conclusion

- where in work poverty was on the rise the poverty reducing capacity of social transfers seems to have declined.Likewise, more adequate social transfers accounted at least partly for decreasing in work poverty in Hungary and in the UK (in the nineties).

conclusion

- Equally important is the issue of *work poor households*
- In many of the rich countries they benefited only partially from expanding labor markets
- Significant and substantial decreases in poverty reduction through social transfers occurred in many of the rich welfare states but also in some of the new Member States
- In many countries poverty increased reaching extremely high levels, ranging from 70% in Latvia over 55% in Germany to more than 40% in Finland, Belgium and Sweden.

conclusion

- Enormous differences in distributional effort
- Thinking about EU wide solidarity presupposes a definition of good fiscal and behaviour and of effective social redistribution

Imbalances in the Eurozone & the position of Germany

Wendy Carlin, UCL & CEPR

April 2012

Should surplus countries adjust?

Standard argument in favour of balanced responsibility for adjustment

- Currency union is two blocs North & South
- South is uncompetitive with current account deficit (and in deep recession)
- North has a surplus and not in recession

Should surplus countries adjust?

- All adjustment is by South
  - this has to be done via nominal wage cuts;
  - likely to require higher unemployment & deeper recession;
  - lowers growth for North as well, via shrinkage of aggregate demand in currency union
- Balanced adjustment by North and South
  - Relieves South of some deflation of nominal wages and demand
  - Global growth is higher
  - Counterpart is higher inflation in North

Should surplus countries adjust?

- Policy in North

  Combination of

  – Wages policy, which encourages higher wage growth
  – Fiscal expansion
- Outcome
  – Real exchange rate depreciation in South; real appreciation in North
  – Lower current account imbalances in new equilibrium
- Balance sheet relative to unilateral Southern adjustment
  – Eurozone – higher growth & higher survival probability
  – South – higher growth; lower debt burden; less deflation; less unemployment: unambiguously positive
  – North – somewhat higher growth; higher inflation; possibly higher debt ratio: ambiguous

Dynamic and political economy considerations – the Northern perspective #1

1. Germany has little fiscal space – it is close to high employment; its rapidly ageing population makes transition to substantial structural surplus more urgent (e.g. than in some of South)
   – If so, benefits to Germany are more limited & costs are higher: disutility of higher debt; higher inflation

Dynamic and political economy considerations – the Northern perspective #2

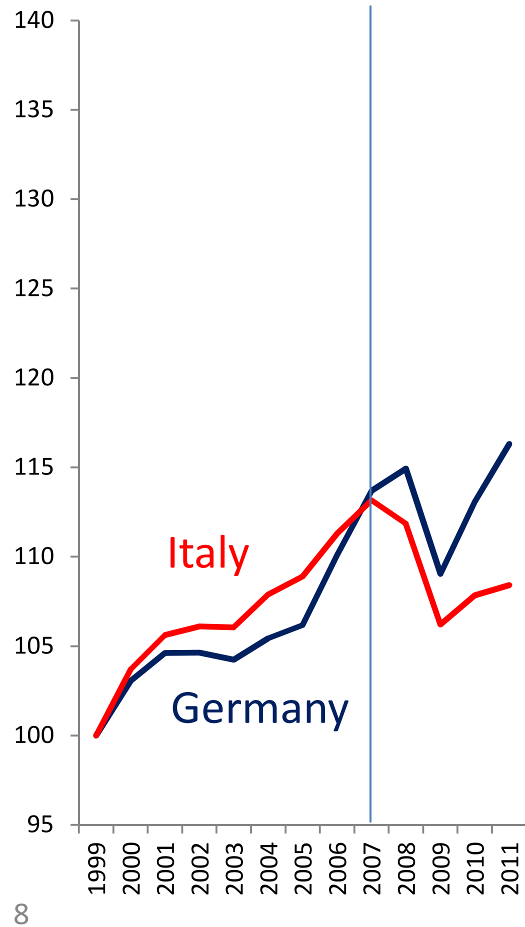
2. Productivity growth & future of ‘good jobs’ depend on export sector; if so, X sector (& not the state) must retain control of real exchange rate

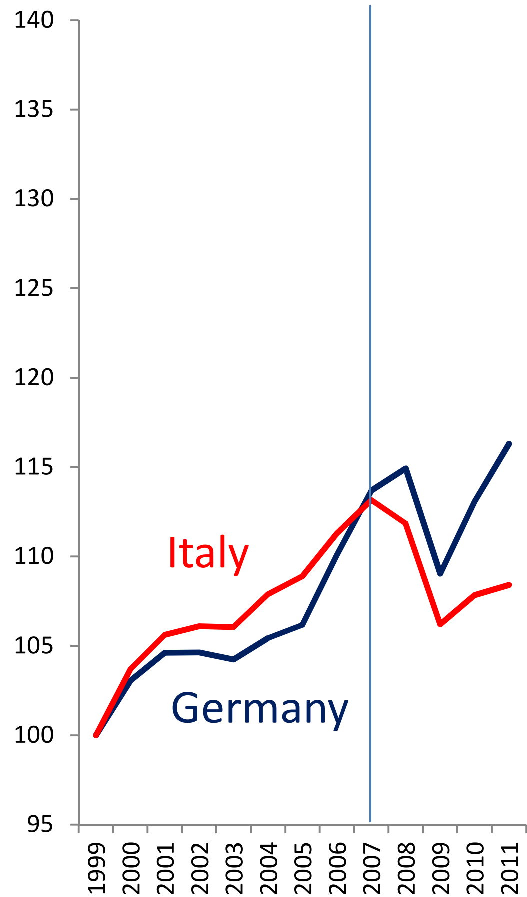
Dynamic and political economy considerations – the Northern perspective #2

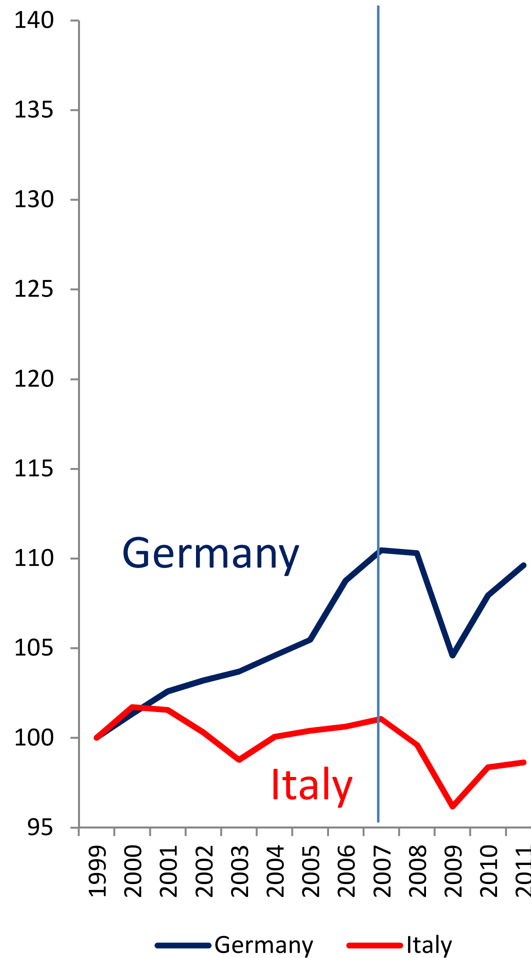
2. Productivity growth & future of 'good jobs' depend on export sector; if so, X sector (& not the state) must retain control of real exchange rate

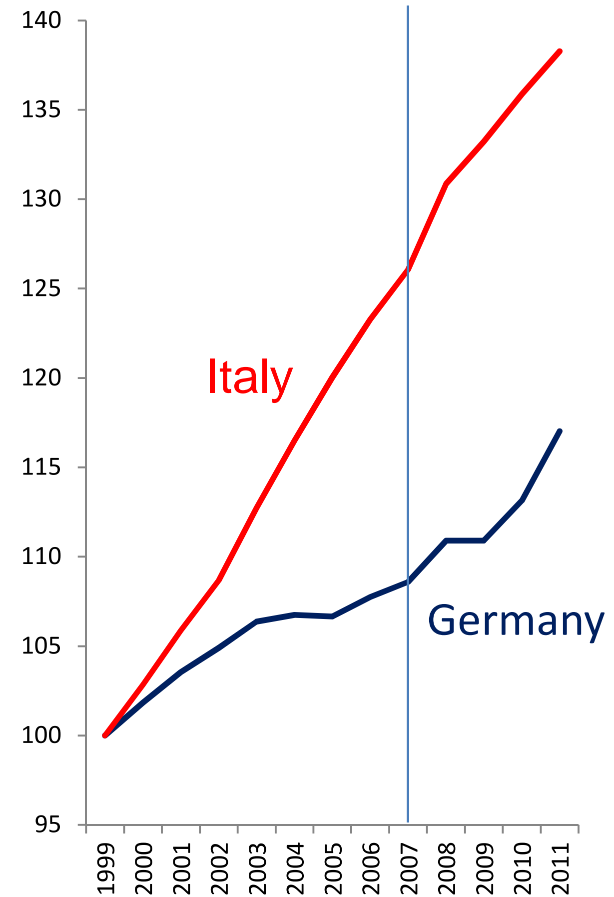
- Why is real exchange rate appreciation via Southern deflation (or via forex market under flexible rates) any different from appreciation via domestic nominal wage growth in North?
  - For political economy reasons
    - the former keep the pressure on firms to innovate to retain export market share
    - the latter undermines innovation model of a coordinated market economy

Germany & Italy were Europe's laggards, 1999-2007









Source: EU Commission

Dynamic and political economy considerations – the Northern perspective #3

3. Asymmetric adjustment sharpens incentives for South to undertake reforms that make reckless or passive behaviour in Eurozone less likely in future

Single currency: successful membership requires

- growth of unit labour costs at ECB target inflation rate and
- ability to adjust real exchange rate to shocks / structural change

Coordinated economies (North) deliver this via private sector

Non-coordinated ones with large wage-setters (South) do not

Dynamic and political economy considerations – the Northern perspective #3 (cont.)

In absence of delivery by private sector, policy must target the real exchange rate

- Fiscal policy councils
  - Active fiscal policy not a debt brake is required (e.g. Spain's budget surpluses & tumbling debt ratio during 1999-2007)

Demands:

- Effective policy-making / governance at national level

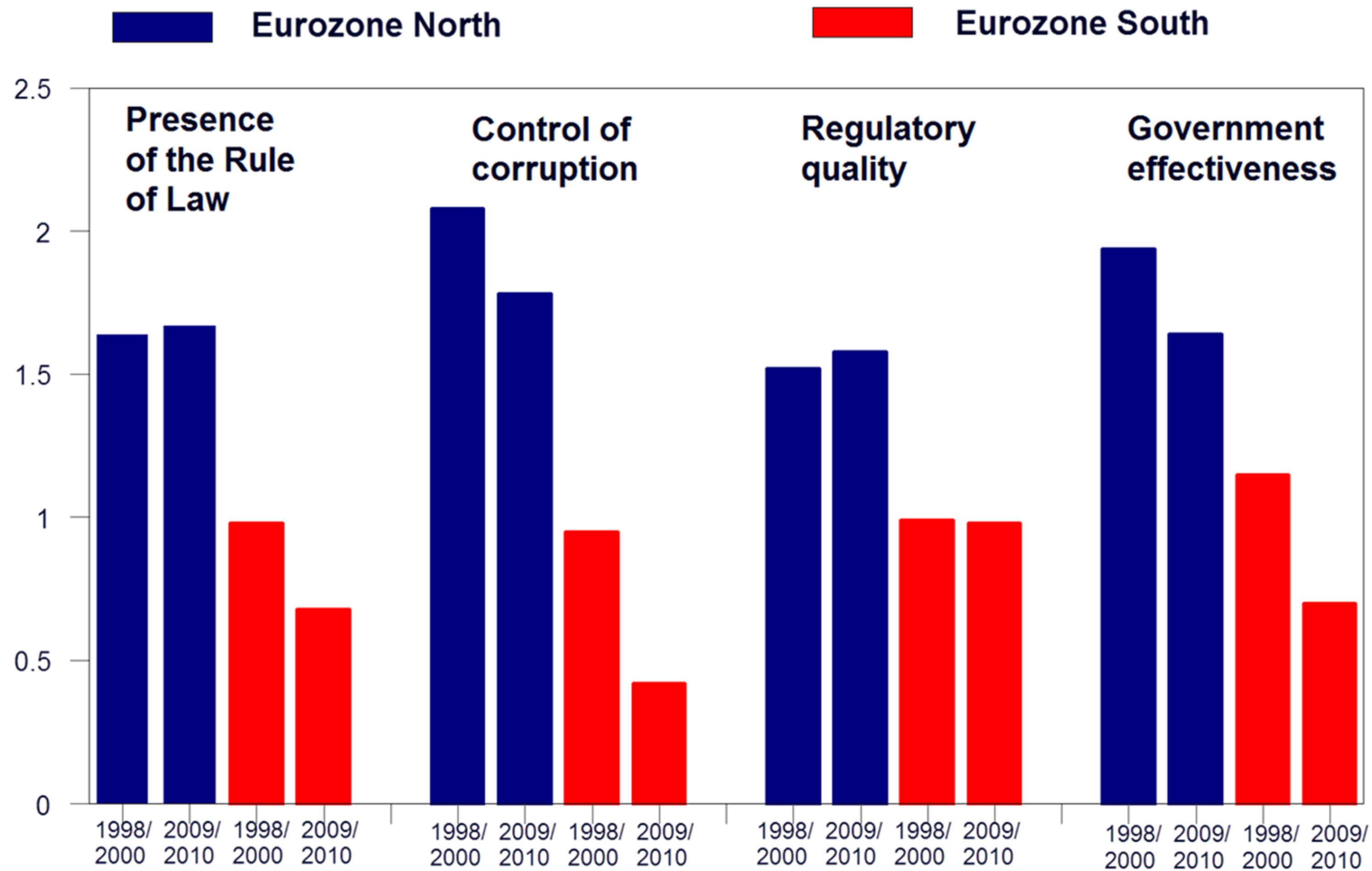
  OR

- Major institutional reforms / change from non-coordination with large wage setters … to a different variety of capitalism (? Latvia)

  OR

- Monitoring by Brussels (& other governance changes)

Governance standards diverged in Eurozone



How compelling are these arguments?

- More scope to increase employment rate in Germany, especially women’s
- Thinking of good jobs only in terms of export sector is too limited & neglects costs of increasingly segmented labour market in Germany
- Another form of wishful thinking is to expect reforms & structural change required in South to take place under conditions of ‘austerity-only’

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Macroprudential Policy Instruments
Lessons from Country Experiences

Francesco Columba

IMF

Institutions of Economic Governance for an Incomplete Union

Managing Private Debt: what policy instruments are required?

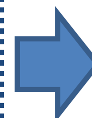
London School of Economics

April 17, 2012

The usual disclaimer applies

Macroprudential instruments and Risks

- Credit-related:
  - Caps on the loan-to-value (LTV) ratio
  - Caps on the debt-to-income (DTI) ratio
  - Caps on foreign currency lending
  - Ceilings on credit or credit growth
- Liquidity-related:
  - Limits on net open currency positions/currency mismatch (NOP)
  - Limits on maturity mismatch
  - Reserve requirements
- Capital-related:
  - Countercyclical/time-varying capital requirements
  - Time-varying/dynamic provisioning
  - Restrictions on profit distribution



Risks generated by strong credit growth and asset price inflation;

Systemic liquidity risk ;

Risks arising from excessive leverage and the consequent de-leveraging;

- including risks related to large and volatile capital flows.

Lessons and Policy Messages

- Instruments that vary through the cycle based on rules have clear advantages and should be used to the extent possible.
- When discretion is necessary, policymakers should explain the rationale behind their actions publicly to enhance policy transparency and effectiveness.
- Well coordinated actions across policy areas are a necessary condition for a successful response to systemic risk
- As with regulation in general, there are costs involved
  - may lower growth unnecessarily,
  - may generate unintended distortions,
  - benefits should be weighed against costs.

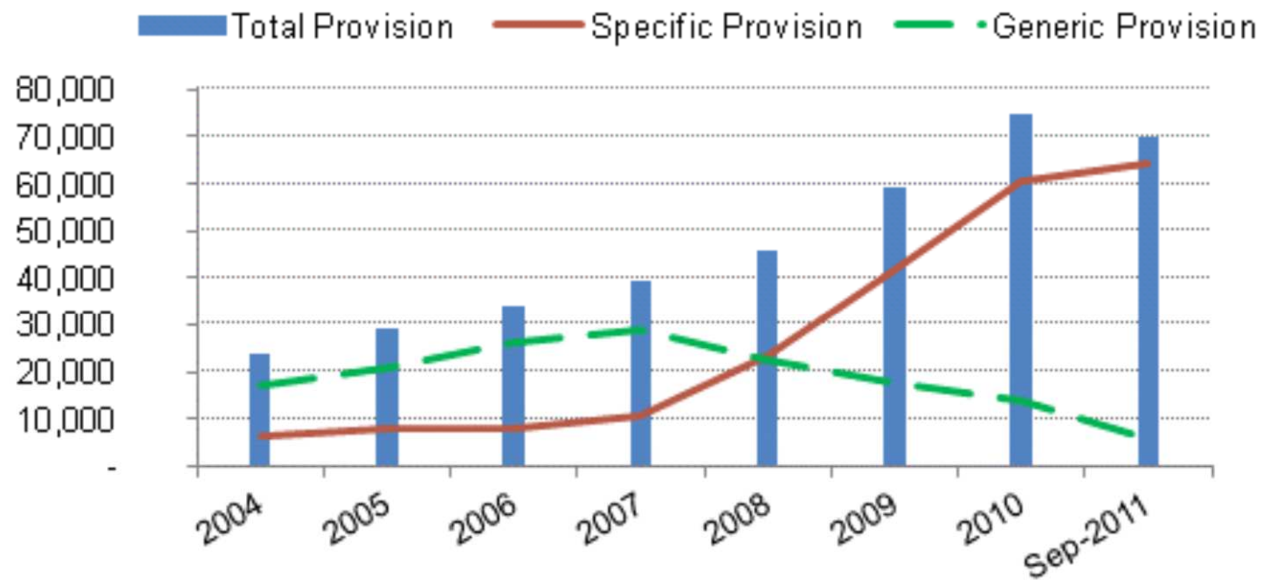
Spain – Mitigating Procyclicality and Building Loss Buffers

- Bank of Spain in July 2000 introduced dynamic loan-loss provisioning with the aim of mitigating pro-cyclicality in the banking sector

- Dynamic provisioning builds a buffer of generic provisions in good times that are used to cover rising loan losses in a subsequent downturn.

- Provisions coverage ratio increased considerably and about half of the rising specific provisions during 2008-09 were covered by the pool of dynamic provisions.

Spain – Outcome: Higher Provisions Buffer



Spain – dynamic provisioning helps but is not sufficient with prolonged and deep crises

- The system helped banks to build up some extra cushion during the cyclical upswing thus allowed them to deal with the first phase of the financial crisis from a better starting point. However, it has failed to generate sufficient provision to cover the expected losses in recent years, due to the following problems:
- *Classification*
- *Through-the-cycle vs. downturn* – The system is based on through-the-cycle expected losses. This might not provide sufficient leeway to release provisions during bad times
- *Backward looking* – The parameters were estimated from historical credit loss information up to 2004
- *Collateral valuation* –lack of a comprehensive and reliable market price database.

Institutions of Economic Governance for an Incomplete Union. A Conference Report

Waltraud Schelkle*

Abstract

This conference report summarizes the contributions and discussions on whether and how the incomplete monetary union can be stabilised in the long run. The conference was held on the 17 April at LSE, sponsored by the EU Representation to the UK, as well as the Centre for European Reform and the Hellenic Observatory.

Keywords: central banking, economic governance, European integration, Eurozone crisis, fiscal rules, social policy

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Institutions of Economic Governance for an Incomplete Union.

A Conference Report

1. Introduction

The financial and economic crisis since August 2007 arrived in Europe about a year after it became apparent in the United States. Just as the Union was coming out of the worst recession of the world economy in post-war history, in December 2009, the markets for Greek bonds started to play up. Within a year, the three countries at the eye of the storm, Greece, Ireland and Portugal, needed assistance from other member states, the EU Commission and the IMF so as to be able to service their debt and pay for public expenditure.[1] In return, the governments in these countries had to commit to severe reductions in budget deficits and profound changes in domestic market regulation. At the EU level, the crisis has triggered a wave of institution-building, in financial supervision, fiscal surveillance and macroeconomic monitoring.

But how fundamental and constructive are these innovations? This is paraphrasing the question that the EU Representation to the UK asked in a call for regional conferences on 'the future of economic governance'. The European Institute at the LSE and the Centre for European Reform responded to this call starting from the premise that these new institutions are unlikely to fill some apparent gaps in economic governance. That is, the future of economic governance consists of an incomplete union in at least three respects.

First of all, there is no central budget that can do counter-cyclical demand management for the Euro area as a whole. This is not an accident but was part of the initial design of the Economic and Monetary Union (EMU). Consequently, there is no reliable fiscal back-up for the rescue operations that the European Central Bank (ECB), like other central banks, had to perform for the financial system over recent years. This adds to the many difficulties of monetary policy for a

[1] The asisstance by member states came through a newly created fund, the European Financial Stability Facility (EFSF) with a capacity to raise up to €440 bn, backed up by the bilateral guarantees, while the support of the Commission via the European Financial Stability Mechanism (EFSM) can go up to €60 bn and is guaranteed by the EU budget.

heterogeneous currency union. The ECB already tries to ensure overall stability of inflation given very different underlying price dynamics as well as the liquidity of a financial system that is insolvent in parts, while governments are reluctant to commit the necessary funds for recapitalising them.

What is the ECB meant to do while governments try to consolidate their budgets, under pro-cyclical market pressure and the Teutonic political reinforcement of these pressures? This was the question with which Adam Posen, member of the Monetary Policy Committee of the Bank of England, started his presentation. He ended on steps towards a fiscal union that, in line with the present philosophy, would be rule-based but much more activist. The commentators took this up, first, by exploring the political limits of monetary activism and automatism (Gavyn Davies, Fulcrum Asset Management) and, second, by outlining the conditions under which the monetary union would be viable without a fiscal union (Jeromin Zettelmeyer, European Bank for Reconstruction and Development).

The second source of incompleteness is the lack of an EU mandate to manage current account imbalances and private debt creation that leads to asset market bubbles. Again, this was not a pure accident waiting to happen. But it was not design either in that the architects of EMU probably thought that imbalances were taken care of by the sheer discipline that a common currency exudes. By foreclosing the option of exchange rate devaluations, wage bargainers would either fall in line due to rational anticipation or uncompetitive firms would have to shed labour until wages are pushed down to a competitive level. By contrast, the excesses of private debt creation and their spillovers in integrated markets were possibly not anticipated. One nominal interest rate for members of the currency union with different price dynamics fuelled the build-up of debt. Since different price dynamics were the side effect of desirable catching up growth in Southern Europe, raising hopes for an emulation of the Celtic Tiger all over, it was also politically unpalatable to act upon the warnings of overheating and the vulnerabilities that go with credit-fuelled booms.

Now that we know the dangers, will next time be different? Paul De Grauwe, John Paulson Chair in European Political Economy at the European Institute of LSE, answered this question by looking at the old and the new surveillance mechanisms for monitoring macroeconomic imbalances in the Euro area. He was not confident that the new institution of an Excessive Imbalance Procedure would spot the problems of credit-fuelled booms. Nor does Paul De Grauwe believe that the procedure leads to the appropriate remedies, a point that resonated with concerns raised in the

previous panel. The commentators tackled several issues that arise from this diagnosis: whether asymmetric adjustment of deficit countries can at least go a long way to remedy the situation (Wendy Carlin, University College London) and to what extent macroprudential regulation (Francesco Columba, International Monetary Fund) or coordinated wage bargaining (Alessandro Turrini, European Commission) can help to rein in macroeconomic imbalances.

The third feature that makes the economic and monetary union incomplete is the absence of a welfare state at the EU level. This has been noted for some time and at least in terms of regulatory social policy and joint reform agendas, a considerable degree of integration has been achieved. But the crisis has again amply demonstrated that for lack of EU-wide transfer programmes there is little the Union can do to ameliorate the hardship of unemployment and prevent social unrest in hard-pressed countries. Hardly any budgetary means also limit the EU's effectiveness in making countries more efficient through social policy. After all, where citizens can fall back on a decent safety net, firms and the civil service have more freedom to hire employees according to merit and fit, rather than out of social obligation. The EU is instead confined to promote 'activating' employment policies in member states, meaning more spending on training and in-work benefits like wage subsidies rather than 'passive' unemployment benefits, implying that most unemployment is a problem of mismatch and lack of qualification on the supply side of the labour market.

How bad is poverty among EU citizens of working age and what have member states done to deal with it? Bea Cantillon, Professor of Social Policy at the University of Antwerp, answers this question for the benign years in the run-up to the financial crisis. She and her collaborators find some convergence in welfare efforts between old and new member states. But the reduced efforts in relatively generous welfare states meant that income support has gone down overall and despite favourable market conditions little progress in the reduction of poverty has been achieved overall. The commentators took up some relevant policy questions that arose from these findings, namely whether different minimum income schemes could actually improve the supply side of labour markets in the long run (Kitty Stewart, LSE), to what extent high pay needs to be tackled along with low pay (Deborah Hargreaves, High Pay Centre) and how difficult it is to devise European policies to combat poverty because it is so difficult to compare the socio-economic situation of vulnerable households across member states (Panos Tsakloglou, Athens University of Economics and Business).

A final panel discussion discussed the vital question of whether the reformed economic governance of EMU helps Greece and other peripheral countries to solve their long-term problems of economic, political and administrative development. Jim Rollo (Sussex University) pointed out the four ways in which a country in crisis can adjust economically in the long run but also that sustaining a primary budget balance is essential fo any viable solution. Antigone Lyberaki (Panteion University) warned of the political backlash that results from support conditioned on budget restraint and reform. Nicos Christodoulakis (Athens University of Economics and Business) suggested that there is too much emphasis on budget consolidation and little by way of reviving growth although he also conceded that Greek governments have not managed to use the funds for infrastructure development that are available.

2. Managing public debt: The monetary-fiscal interface

The strict separation of monetary and fiscal policy, on which the EMU architecture was premised, could not be maintained. The ECB had to step in and interrupt the feedback loop between impaired bank balance sheets and deteriorating government finances by buying government bonds from financial institutions. Only the future can tell what this will mean for fiscal authorities in terms of reduced central bank seignorage and even the need to recapitalise the European System of Central Banks. A more immediate question is how monetary policy can support fiscal policies in getting back on a viable path of public debt accumulation.

2.1. Presentation by Adam Posen

In his rich talk on 'Towards activist rules: the future of fiscal-monetary policy interactions and beyond', Adam Posen (Monetary Policy Committee, BoE) noted that he is not worried about the close interaction between monetary and fiscal policy that the crisis has called for. He made essentially five arguments. First of all, he outlined a 'transatlantic lesson', namely that macroeconomic policy should follow activist policy rules – with the United States arguably in need of more rules and the Euro area in need of more activism. For monetary policy, this means that central banks should be an active and forward-looking participant in financial markets. For fiscal policy, this means that responses should be as automatic and symmetric over the business cycle as possible. The bottom line is that discipline does not mean to refrain from intervention and that the counter-cyclicality of this intervention is key.

The second argument was a reminder that the fiscal problems in the Euro area are a result and not the cause of the crisis. This claim was supported by a number of regressions. They showed, inter alia, that spreads of bond yields over the Bund benchmark correlate positively with current account imbalances. Trade imbalances seem to have been driven more by private debt accumulation than public debt. UK bonds carry a significantly lower spread than countries with similar current account deficits, arguably a benefit of its independent monetary policy.

The third argument concerned the exit of central banks from monetary easing and Adam Posen stressed that monetary exit is not a problem, only premature exit is. Just as the increase in central bank balance sheets did not happen overnight, so exit will be a temporary and transparent, pre-announced process.

The fourth argument answered the question how monetary policy can support fiscal consolidation to achieve the goal of reducing public debt. Adam Posen presented the findings from joint work with colleagues at the Bank of England[2], that strongly support monetary accommodation ahead of the fiscal restraint as being the strategy that is more conducive to successful consolidation. This goes arguably against the more confrontational style that the ECB practices, at least in rhetoric, asking governments to engage in fiscal austerity as a pre-condition for its own credit easing.

The last point was the most forward-looking and urged the governments of the core Euro area to deliver on their part of the deal, in their own interest. Credibility is required from deficit and surplus, debtor and creditor countries. Adam Posen thus urged these governments to commit on fiscal stimulus, wage increases and structural reforms that raise domestic demand in the core, so as to be consistent with the GIPSI's commitment to fiscal constraint and export growth. This will be required on top of debt forgiveness and sizeable counter-cyclical transfers to stop the downward spiral in the latter economies. The fiscal compact as agreed does not help very much in this respect, as it imposes one-sided adjustment and restraint on countries frozen out of bond markets while those with room for manoeuvre are not requested to stimulate.

By contrast, more automatic and more symmetric responses would help to overcome obvious coordination problems of a large monetary union. Adam Posen concluded on a number of far-reaching reforms that would create counter-cyclical fiscal transfers as automatic stabilisers for the Euro area as a whole. His specific examples were unemployment insurance, a real estate tax, infrastructure funds and taxes on excessive current account surpluses.

2.2. Comments by Gavyn Davies and Jeromin Zettelmeyer

Gavyn Davies (Fulcrum Asset Management) agreed on major points that were made, first of all that the Euro area crisis originated in markets, not in government balances, which is not categorically different from the U.S. and the UK. Regulatory failure was part of the story, in particular the rating of all Treasury bonds as safe assets that allowed German and French banks to buy up Greek bonds rather carelessly. He also shared Adam Posen's view that what is now done, under German leadership, is not very helpful for getting the euro area out of this crisis. The German government, with its insistence on public sector tightening in the deficit countries, fails to

[2] See Hellebrandt, Posen and Tolle (2012)

acknowledge the transfer problem of debt repayment, which is rather odd given the historical experience of Germany.[3] Like surplus countries before, Germany seems to be blind to the fact that austerity at the pace now required from countries like Spain is counter-productive, worsening the budget balance by trying to achieve deficit reduction so quickly. This is inexcusable even if one does not quite go along with Adam Posen's message that the Euro area should become like the US and have a full-fledged federation – this took the United States at least 150 years.

The point of contention between Gavyn Davies and Adam Posen was whether it is politically and economically feasible for monetary policy playing the role it does in managing the Euro area crisis. In many ways, the ECB balance sheet plays now the role of financing arrangements that temporarily can hold together fixed exchange rate regimes with huge imbalances. These arrangements expose taxpayers in creditor countries to considerable losses that have not been signed off by parliaments and which are not obvious to electorates. Gavyn Davies therefore doubts that this is safe and democratically legitimate. Moreover, the seignorage gains from elevated inflation rates of central banks may not be enough or trigger more inflation than warranted if they have to be realised very quickly in order to save the Euro area. Thus, Gavyn Davies is sceptical that the ECB can substitute for the missing fiscal union as Adam Posen can be understood to suggest when he claims that monetary exit is unconstrained

Jeromin Zettelmeyer (EBRD) discussed whether reforms would suffice that are less wide-ranging than those Adam Posen proposed. In particular, can the Euro area survive if an 'enlightened German view' prevails in crisis management -- even though Jeromin Zettelmeyer does not share the German view and would be in favour of EMU taking the next step and go for fiscal union? This German view has two crucial elements: first, fiscal union is ruled out for the foreseeable future and, second, the crisis is seen as the result of poor policies in deficit countries, hence the burden of adjustment is on them. Given these constraints on any solution, fiscal policy can still be effective in responding to shocks or in smoothing national business cycles, as long as three conditions are fulfilled: Governments must be solvent, their fiscal policies flexible (or active, to use Adam Posen's term for monetary policy) and fiscal authorities must have access to bond markets. In essence this is the role for fiscal policy that the IMF foresees for fixed exchange rate regimes. It would prevent that governments have to push so hard on the brake as to be self-defeating, for

[3] The term was coined by J.M. Keynes with reference to Germany's need to repay debt under the Versailles Treaty. He considered the amounts requested to be self-defeating because of the effects on the terms of trade. Gavyn Davies' point is on the uncontroversial part of Keynes' article, namely that debt repayment requires to drive down domestic absorption in order for a budgetary and a current account surplus to ensue.

itself and others. There are tradeoffs between these three requirements for effective fiscal policies that can no longer rely on monetary policy to support it: A balanced-budget rule can obviously ensure solvency but it does so by completely negating flexibility. Or a unified hard currency does help governments with market access but the moral hazard involved compromises on solvency – hence the German insistence on a Stability Pact.

At the EU level, national fiscal policies that strike a balance between solvency, flexibility and market access need to be supported by three institutions: a rescue mechanism that kicks in if necessary, conditional on good fiscal behaviour; a benchmark of what good fiscal behaviour means while leaving some room for flexibility and for member states that are too big to rescue; and a commitment of the central bank to step in. How does the fiscal compact perform against this enlightened German solution? In Jeromin Zettelmeyer's view, it is ill-designed because the fiscal compact relies on constitutional balanced budget rules. In order to strike the right balance between solvency and flexibility, it is much more desirable to constrain debt stocks and allow the flows of budget deficits taking care of the changes in the economic situation. Moreover, he misses a commitment of the ECB to come to the rescue of big economies like Spain that have shown good fiscal behaviour. He concluded that fiscal union does not logically require monetary union but for this to be the case, fiscal policy must fulfil the conditions outlined above.

2.3. Discussion

Four questions were raised in the discussion. First of all, even if fiscal union is not necessary logically would it not make things a lot easier practically? Or contrary to even a very enlightened German view, can some form of fiscal union really be ruled out, given that then the ECB will be forced repeatedly to intervene in bond markets, because governments that no longer control their money supply can be forced by market speculation into pro-cyclical restraint? But also, is there not more of a fiscal problem than the panel acknowledged with its consensus that the crisis was not caused by fiscal indiscipline? And finally, is there really an inflationary threat from the ECB's enlarged balance sheet if broad money supply (M3) is virtually stagnating?

3. Managing private debt: Old and new instruments

Philip Whyte from the Centre for European Reform (CER) outlined the two broad assumptions on which EMU was predicated: On the one hand, that compliance with fiscal rules would do the trick and, on the other, that current account imbalances between member states would become as irrelevant as they are within these countries. Both of these assumptions have been called into question by the crisis of the last few years. Current account imbalances and divergent increases in labour costs were better predictors of the countries that came under pressure than fiscal deficits. In response, the EU has established a new framework. Macroeconomic imbalances will be monitored and financial institutions will be subject to macroprudential regulation; it is not yet clear how the two new elements of economic governance will interact. Nor is it clear how symmetric the adjustment of surplus and deficit countries should be and how much wage developments can contribute to this adjustment.

3.1. Presentation by Paul De Grauwe

In his presentation on 'Managing imbalances in the Eurozone', Paul De Grauwe (LSE) asked three questions. First of all, are the crises that the EU framework now tries to prevent the only possible crises that can occur? Will the indicators established recognize a crisis that is caused by excessive private credit, which is arguably the Spanish case? And if recognized, are the instruments to be used and the actors roped in enough to prevent or resolve a crisis? Throughout, Paul De Grauwe used the example of the Spanish imbalances because the credit-fuelled boom there was fairly typical and it is a country crisis that EMU must prevent because it is a member too-big-to-rescue without a fiscal union.

The Spanish crisis resulted from excessive credit growth that led to real estate bubbles, high household debt and a current account deficit. But not all crises are of this sort. Sweden seems to develop a housing market bubble at the moment that started, however, with an export boom. This is a potential for crisis that the now Excessive Imbalances Procedure (MIP) would find difficult to spot because indicators point in different directions (see the scoreboard with the relevant indicators below). That holds even for the Spanish crisis: like all credit-fuelled booms, it is typically associated with budget surpluses, high growth and falling unemployment.

Table I.1: MIP scoreboard 2012 (1)

Year 2010	External imbalances and competitiveness					Internal imbalances				
	3 year average of Current Account Balance as % of GDP	Net International Investment Position as % of GDP	% Change (3 years) of Real Effective Exchange Rate with HIPC deflators	% Change (5 years) in Export Market Shares	% Change (3 years) in Nominal ULC	% y-o-y change in deflated House Prices	Private Sector Credit Flow as % of GDP	Private Sector Debt as % of GDP	Public Sector Debt as % of GDP	3 year average of Unemployment
Thresholds	- 4/6%	- 35%	± 5% & ± 11%	- 6%	9% & 12%	+ 6%	15%	160%	60%	10%
BE	-0.6	77.8	1.3	-15.4	8.5	0.4	13.1	233	96	7.7
DE	5.9	38.4	-2.9	-8.3	6.6	-1.0	3.1	128	83	7.5
EE	-0.8	-72.8	5.9	-0.9	9.3	-2.1	-8.6	176	7	12.0
IE	-2.7	-90.9	-5.0	-12.8	-2.3	-10.5	-4.5	341	93	10.6
EL	-12.1	-92.5	3.9	-20.0	12.8	-6.8	-0.7	124	145	9.9
ES	-6.5	-89.5	0.6	-11.6	3.3	-4.3	1.4	227	61	16.5
FR	-1.7	-10.0	-1.4	-19.4	7.2	3.6	2.4	160	82	9.0
IT	-2.8	-23.9	-1.0	-19.0	7.8	-1.5	3.6	126	118	7.6
CY	-12.1	-43.4	0.8	-19.4	7.2	-6.6	30.5	289	62	5.1
LU	6.4	96.5	1.9	3.2	17.3	3.0	-41.8	254	19	4.9
MT	-5.4	9.2	-0.6	6.9	7.7	-1.6	6.9	212	69	6.6
NL	5.0	28.0	-1.0	-8.1	7.4	-2.9	-0.7	223	63	3.8
AT	3.5	-9.8	-1.3	-14.8	8.9	-1.5	6.4	166	72	4.3
PT	-11.2	-107.5	-2.4	-8.6	5.1	0.1	3.3	249	93	10.4
SI	-3.0	-35.7	2.3	-5.9	15.7	0.7	1.8	129	39	5.9
SK	-4.1	-66.2	12.1	32.6	10.1	-4.9	3.3	69	41	12.0
FI	2.1	9.9	0.3	-18.7	12.3	6.6	6.8	178	48	7.7

(1) The shaded cells in the table mark values that fall outside the scoreboard thresholds.
Source: Commission services

But monitoring macroeconomic imbalances is not only a cognitive problem, it is above all a political problem. The European Commission will have to be bold enough and ask for the music to stop when the party is still fun. But even if the EU, the Commission and the Council, muster the courage and recommend to open an Excessive Imbalance Procedure against a country at the end of which it can be fined, what instruments can be applied to reduce the imbalance? To tackle it at the source, a credit-fuelled boom requires restricting private credit. Yet this is very difficult to do for a national fiscal authority. The Spanish authorities tried via macroprudential regulation but it was not enough to prick the real estate bubble. Only the ECB would be able to stop a credit boom. What if the ECB does not use its powers? The new framework does not hold the ECB accountable for excessive imbalances, in fact it is not even involved in the surveillance process. Yet, the ECB seems not to have recognized the credit explosion in certain member states and has in any case not done anything to restrain them, for instance by raising reserve requirements as Paul De Grauwe later responded to a question in the discussion.

In conclusion, Paul De Grauwe is not very optimistic that future crisis can be prevented by the MIP. Any future crisis, always a bit different from the last, will require some mechanisms to support the countries in crisis and a degree of solidarity from the well-off members. Because what inevitably happens is that some countries are then pushed into a bad equilibrium and others into a good equilibrium – with the ironic twist that it is the latter who complain. This cumulative nature

of crisis shifts income and employment to those that are asked to assist. Solidarity therefore just means sharing their good fortunes with those less fortunate.

3.2. Comments by Francesco Columba, Wendy Carlin, and Alessandro Turrini

Francesco Columba (IMF) took up one point of the previous presentation, namely to what extent macroprudential regulation can prevent imbalances.[4] Macroprudential regulation encompasses measures that financial supervisors take in order to prevent systemic crisis, for instance higher reserve or capital requirements for banking systems where credit growth is deemed to be excessive. The policy lessons that Francesco Columba and his collaborators draw from a) in-depth country studies, b) the statistical analysis of credit growth before and after measures were taken as well as c)more sophisticated econometric analyses are: First, the instruments commonly in use seem to reduce the pro-cyclicality of financial markets and to a lesser extent common exposures to similar risks as well as the likelihood of spillovers. Moreover, the effectiveness of instruments seem to depend neither on the exchange rate regime nor on the size of the financial sector. Finally, authorities should use different instruments for different risks, so sole reliance on capital requirements will not do. All in all, the findings are encouraging but do not contradict Paul De Grauwe's conclusion that they cannot do the trick of preventing future crises.

Wendy Carlin (UCL) discussed the arguments for surplus countries to adjust symmetrically with deficit countries, but also for deficit countries to adjust asymmetrically.[5] The arguments in favour of Northern surplus countries doing their bit – as Paul De Grauwe had suggested – rests largely on economic reasons, such as higher growth for the Euro area as a whole and less severe contraction in the South. The economic case from the perspective of surplus countries is not as unambiguously positive as they would have to accept somewhat higher price increases and less budget consolidation in return for higher growth (given the more robust performance of export markets). The arguments for one-sided adjustment – what Jeromin Zettelmeyer had portrayed as a tenant of the German view – are of a dynamic and political economy nature.[6] Wendy Carlin mentions in particular two reasons why Northern countries insist on deficit countries bearing the brunt of adjustment. On the one hand, this keeps up the pressure on Southern firms to innovate in

[4] A fuller discussion and further references can be found in Columba, Costa and Lim (2012).
[5] See for a fuller discussion Boltho and Carlin (2012) on voxEU: http://www.voxeu.org/index.php?q=node/7808 (accessed 22 April 2012)

[6] Note in the scoreboard above that the threshold for an excessive deficit is 4% while that for an excessive surplus is 6% of GDP, arguably an asymmetric definition of excessive imbalances. Note also that the German current account surplus happened to be 5.9% and therefore not excessive.

order to keep up their export market share. It would undermine the innovation model of countries with highly coordinated policy processes between social partners, on the other, if they were urged to let a stimulus feed into relatively higher nominal wages. Her conclusions are that Northern countries generally, Germany in particular, have space to increase employment and expand sectors other than those oriented towards exports; and that it is wishful thinking to believe that Southern countries can deliver reform and consolidation under permanent fiscal austerity.

Alessandro Turrini (European Commission, DG Ecfin) finally tackled the question to what extent wage adjustment can help to rein in current account imbalances. Recommendations to that effect are part of the new coordination procedure of a European Semester, the conditionality in programme countries includes labour market reforms and the MIP presupposes that some adjustment takes place there. With respect to the latter, Alessandro Turrini responded to the critique of Paul De Grauwe that indicators would point in different directions for a typical credit-fuelled boom. While the rationale for wage adjustment is clear-cut, we should not expect it form market adjustment as wages do normally not respond to current account imbalances but to unemployment; and even if they did, the change in relative prices of export and import prices that can be achieved through wages would probably be too slow. Hence, policy instruments like 'fiscal devaluation'[7] and more responsive forward-looking wage bargaining institutions must bring the necessary changes about. But practical implementation problems abound, for instance how to achieve the appropriate calibration of income and consumption tax measures, or how wage setting institutions can internalise their macroeconomic effects.

3.3. Discussion

The discussion touched on a number of interesting and relevant questions: how can this long list of indicators on the scoreboard ever help to get a sense of what the particular situations of a country is? If the relevant indicators point in different directions, does the selection become an arbitrary exercise or does it help to tell and act upon a relevant story for each situation? Following on from this, how can the EU try to define rules and standard recipes for crisis management if all crises are different? If not all countries in the Euro area can have a surplus, do all have to have a balanced current account? How can Southern countries uncover their comparative advantages, given that there is not one recipe, not even for all Southern economies? What should the ECB have done to

[7] This refers to changes in the tax system that emulate the effects of exchange rate devaluation, eg lowering the taxes on labour income or social security contributions, and rising consumption taxes. This should make goods produced at home less expensive and goods consumed at home more expensive. See Farhi et al (2011) for further elaboration.

prevent credit explosion in particular countries? Or, to take the alternative, how much can the EU rely on wage bargains to do the adjustment in the European monetary union if capacity to coordinate is confined to national economies at best and very unevenly distributed among countries in practice?

4. Managing social imbalances: the EU's welfare trilemma

John Springford from the CER opened the session by outlining what might be called the EU's welfare trilemma: how to combine fiscal tightening with growth but also fairness or equality? It seems that one always has to give in order to achieve the other. Fiscal tightening may be combined with growth but the EU may then have to throw out fairness from the social compact that underpins European integration. Fiscal tightening may go together with equality by making the rich contribute a much larger share but then growth could suffer. Or growth and equality may be achieved but fiscal consolidation may have to be compromised. What is the state of play on this welfare trilemma?

4.1. Presentation by Bea Cantillon

In her presentation on 'Managing social imbalances', Bea Cantillon (University of Antwerp) addressed this welfare trilemma by asking how poverty rates changed due to market processes for a period of relatively high growth just before the crisis and due to welfare state efforts, with governments taking different stances on fiscal tightening. She broke this down into four substantive questions. First, has poverty of those in work increased as many observers of European welfare reforms suspect? Second, where does in-work poverty come from, from low pay as traditional welfare analysis would lead one to expect or from certain household constellations as the new risk literature[8] suggests? Third, how does poverty vary with the intensity of work, in other words how does in-work poverty compare with poverty out of work or in part-time work? And finally, what difference does the welfare state make for the poverty of those in work and those with low job attachment?

Poverty risks of those in work have not increased across the board in Europe but in Germany, Finland, Greece, Latvia and Sweden. At risk of poverty is here measured as disposable income falling below 60 percent of equivalised median income. Equivalisation takes account of household size by dividing the income available by the number of household members, with some adjustment for the fact that children need less income than adults. If one tries to disentangle where this comes from, it is noticeable that low pay per se is a weak predictor of poverty risks. Many of those who have low paid jobs do not live in poor households. What makes for a relatively high poverty risk is low work intensity at the household level due to precarious or forced part-time

[8] See Taylor-Gooby (2004)

employment, but above all only a single earner in a family. Single parents are overrepresented among the working poor but the majority live in a household with two adults and dependent children. In turn, the rise in average living standards over these years was more driven by multi-earnership, that is the demise of the male breadwinner model, than by rising wages; low paid jobs can contribute to rising living standards in such circumstances.

Welfare state effort made a considerable difference to how those at risk of poverty fared. First of all, the work intensity that is so crucial for in-work poverty risks is influenced by the tax and transfer system that can make it worthwhile – or not – for women with carer responsibilities to take up paid employment. In almost all countries, but in particular in the 'old' member states, social protection in terms of cash benefits declined more than social needs as measured by caseloads. The exceptions to this trend were notably some new member states that mostly maintained their cash benefits relative to disposable income. The poor who are mostly out of paid employment experienced cut-backs in benefits in Germany, Denmark, Italy, Ireland, Sweden, Latvia and Estonia. But this motley set of countries also suggests that very different political agendas may have been operating here. They are different not only in levels of generosity and universality of social protection but also in the degree to which they pursued activation, ie inclusion through the labour market, which EU social policy certainly promoted.

4.2. Comments by Kitty Stewart, Deborah Hargreaves, and Panos Tsakloglou

Kitty Stewart (LSE) proposed different ways of thinking about work incentives of income support for the working age population. The focus on reservation wages should be replaced by a focus on minimum wages and basic income support. A universal tax credit and other forms of transfers that are independent of labour market status can combine adequate support with maintaining work incentives. But they are obviously not cheap in budgetary terms, which is why we see that many countries move away from universalism. Instead one should ask who could pay or what else could be sacrificed? Cash benefits are an easy target but, as Bea Cantillon showed, cutting them back is quite regressive, hurting the less well-off disproportionately. Cutting services is less regressive but certainly not helpful for social investment and the productivity of the economy in the long run. This leaves, in Kitty Stewart's view, only higher progressive taxes. Her final point concerned a possible interpretation of Bea Cantillon's findings, namely that we should not care so much about low pay -- a reading that Bea Cantillon did not endorse in her response. While it is a valid point that low work intensity may be as important a problem to be ameliorated, for instance, by free

child care, Kitty Stewart argued that one needs to be concerned about low pay still but perhaps improve on the targeting of the minimum wage, by introducing them for age groups of 30+ only.

Deborah Hargreaves (High Pay Centre) took up this latter suggestion and observed that the importance of a minimum wage is realized more widely, thanks to the fact that the experience of low pay is now one that even middle-class families make. Both breadwinners and their teenage children may have to accept low paid jobs. She stressed that the huge increases of inequality – of which she gave graphic indicators -- directly divert resources away from those on middle to low income, yet is not just a matter of those at the top getting a larger slice of an increasing pie. She also recalled the valid economic reasons for why one should tackle excessive pay at the top. Extreme discrepancies between the pay of management and those on the shop floor have been shown to lead to worse performance because morale and the motivation to use resources efficiently is low among those who do not get a fair share. Moreover, the analysis of the reasons for the crisis has arguably shown that high pay directly feeds a bubble economy. Governments should therefore think of ways of empowering shareholders to prevent such discrepancies between high and average pay in enterprises. Attempts in this respect can be observed in the Netherlands and other countries.

Panos Tsakloglou (Athens University of Economics and Business) opened by summarizing the experience with active labour market policies. Measures like in-work benefits, training measures and wage subsidies were thought to deal with unemployment and poverty at the same time. But while employment rates increased, especially among women, jobs often went to secondary earners rather than those in precarious employment. So the need for spending on cash benefits has largely remained the same. He also stressed that the paper of Bea Cantillon argues for minimum income, not for minimum wages, and in favour of rather high levels at that. As an economist who is in principle in favour of a minimum income guarantee, he wonders not only what that would do to work incentives but also whether this would not create serious insider-outsider problems.

This raises the question what could be done at the EU level. A number of problems arise from the fact that the EU has such different living and welfare standards. This requires taking absolute poverty into account as well. But the EU and its member states refer to a relative poverty standard, eg defined as 50% or 60% of median income, yet this means something very different in Romania and in France. Moreover, right now we measure a rapid increase in (relative) poverty in Ireland but this rise comes after a massive rise in living standards. The anchor of a median income may

also mean that the rise in poverty in Greece is underestimated because inequality did not increase very much due to profits falling even more than other income. This raises the more general question whether the distribution of disposable income is relevant for these welfare comparisons at the lower end of the income scale. Panos Tsakloglou does not think so as this income measure does not take into account the availability of public services (eg free schooling) or the prevalent housing situation (in particular homeownership among the elderly). Substantial changes in taxation are also likely to do more to the distribution of disposable income than cash benefits. For instance, the reduction in capital taxation almost everywhere has led to rising inequality even though the distribution of disposable income and the income tax system did not change that much. Finally, the poverty rate has one and only one advantage, namely that it is easy to understand by lay people. But it tells us very little or is even misleading if we are concerned about minimum income protection which is usually way below the 60% level. Notably in Portugal, the at-risk-of-poverty rate has hardly changed but the intensity of poverty has increased considerably. So other indices are necessary, such as poverty gaps and material deprivation (which the EU does measure as well). The more general point is that unlike unemployment, poverty is a construct of social scientists who establish a threshold below which somebody is classified as poor.

4.3. Discussion

The discussion picked up the issue of low pay. To what extent have low paid jobs been legislated so as not to touch rigid labour markets, as part of a bargain with insiders? A similar question can be raised with respect to the redistributive effort: even when social expenditure increases overall as in Greece, how much of the additional spending goes to the poor? The bilateral agreements between Switzerland and the UK and the German government, respectively, fit into that picture as they legalize tax evasion for high income earners. As regards EU social policy, one could contemplate an EU poverty line that is defined in terms of purchasing power standards. A final question concerned the measurement of work intensity and to what extent people are actually either in full-time work or not in work, rather than somewhere in between, as this might affect the finding that low work intensity is a higher risk factor for poverty than low pay.

5. Dealing with long-term problems in peripheral countries

The chair of this panel, Kevin Featherstone (European Institute and Hellenic Observatory, LSE) opened the panel by saying that this is probably the most basic question of all about the future of the monetary union. Can reformed economic governance address the long-term problems of Greece and other countries in the Eurozone periphery?

The economist's answer was given by Jim Rollo (Sussex University) who gave qualified support to the focus on fiscal consolidation. He argued that even if fiscal consolidation is not the sole problem to solve, any country in crisis will have to run a primary balance or surplus, whether it remains inside the Euro area or leaves it. In the latter case, a balanced budget would be even more imperative as there was nobody to lend to it any more. Apart from this non-choice, all adjustment is a combination of reducing labour costs, debt forgiveness, inflation and, above all, growth. Europe-wide automatic stabilisers that Adam Posen proposed at the end of his talk would have helped not to get there in the first place but they are not available in the near future. Absent these stabilisers, the adjustment that Greece or Spain are asked to achieve is draconian but not impossible to accomplish, although very hard to do in democracies. An area where the EU must deliver more is the supply-side of growth. Improvements in the infrastructure are needed and the European Investment Bank could do more to fund these. Labour market reforms are part of this package. Because devaluations are not possible, price adjustment can only come from real wage adjustment. Jim Rollo said that in this situation, low paid jobs should not be dismissed as part of the solution. This way employment seekers, and especially young entrants to the labour market, get a chance. Their migration to places like suburban London, working in all kinds of entry-level jobs, shows that they prefer low paid employment to no employment.

After this exposition of an economist's answer, Antigone Lyberaki (Panteion University) talked about the political will to reform, or rather the lack thereof. She pointed out that the EU's Lisbon Strategy with its Open Method of Coordination failed to stimulate change in member states even if they needed reform badly. But this policy process could not create the constituencies for reform. Now this Open Method is supplemented by a much more interventionist and intrusive model in the programme countries. But for the country that she knows from inside, Greece, Antigone Lyberaki was sceptical that this will spur reform. The Memorandum of Understanding that spells out the reforms, set as conditions for further assistance, is seen as a diktat by lenders. This creates a

backlash in which even previous reformers are driven into the anti-reform camp. The problem is that the electorate at large has been deceived over the need for fundamental change. In the course of this, a mind-set has been created that has got used to blame others and indulges in thinking that the outside world owes Greece. Academics are also to blame for this as they have either remained silent or joined the blame shifting. Antigone Lyberaki was pessimistic that this can be changed any time soon.

Taking up this exposition of the political obstacles to solve the long-term problems, Nicos Christodoulakis (Athens University of Economics and Business) spoke about the policies called for. As a former economics minister in the Simitis administration, he is one of the reformers who now opposes the stability programme in Greece. Supporting Antigone Lyberaki's diagnosis, he noted the paradoxical situation that in the election campaign everybody who runs for office is criticising the stability programme vehemently but will in the end accept the conditions when it comes to the vote in parliament. In his view, one of the main failures of the programme is that it imposes a contraction of the economy that is self-defeating in bringing down the debt-to-GDP ratio. If a less drastic approach had managed to make Greece merely stagnate over the last five years, instead of contracting the economy by 18%, the debt ratio would now be at 132% of GDP, about 26% lower than it was at the beginning of 2012. The other main failure is home-made in that the Papandreou government was arguably too complacent in 2009-10, having won the election in 2009 on the untenable promise that Greece could spend its way out of recession. It did not fight tax evasion, did not privatise and slashed public investment instead of current expenditure. A 'Third Way' between the outside imposed austerity and domestic complacency is therefore needed. Nicos Christodoulakis asked for austerity measures to stop until growth has resumed, for the bailout loans to actually finance investment rather than the servicing of debt, and the responsibility for fiscal adjustment must be given back to the government as there is no legitimacy for outsiders to take this responsibility. The programme should therefore be contracted directly between Greece and the EU, with the IMF stepping down. Later in the discussion, Nicos Christodoulakis specified that he would think the fiscal compact would be a better framework for an adjustment programme than the IMF-assisted stability programmes.

The chair, Kevin Featherstone, opened the debate by asking Jim Rollo how his recommendations differed from the current strategy, except that Germany and other creditor countries seem not to be willing to support the investment part – a point resonating with the earlier remark by Adam

Posen that the present strategy lacks time consistency from the creditors' side. Jim Rollo responded by outlining the differences. The steps he deems necessary would not include constitutional balanced budget rules, as the fiscal compact does, which amount to making counter-cyclical stimulus measures illegal. He would urge the cyclical element of growth to be kept under review instead of devising all adjustment in terms of the statistical artefact of structural balances. And finally, the timing of adjustment must be much more attenuated than present plans foresee. Later in the debate, Jim Rollo was challenged on the need for a primary balanced budget because outside the Euro area a government could simply print money to balance its budget. This was not considered as a viable solution and both Nicos Christodoulakis and Antigone Lyberaki seconded Jim Rollo in recalling that Greece's experience with exchange rate devaluations and monetary autonomy were far from encouraging.

The chair then asked Antigone Lyberaki how any new Greek government can persuade creditors to invest in the country or will be able to implement new rounds of austerity if she is right and the political will to adjust is indeed so shallow. Antigone Lyberaki rested her case and urged 'friends abroad' to raise their voice but also express support for Greece, in the hope that sympathetic critique can lead to the fundamental domestic debate that is required for any lasting change. She was later challenged on this need for fundamental debate in that the questioner asked how much time Greece needs for a debate they could have had for some time now while the crisis calls for immediate action. Panos Tsakloglou contradicted her assessment as overly pessimistic and argued that political will has not remained as stubbornly anti-reformist as she suggests: opinion polls taken two years ago showed indeed that a majority did not see the need for reform but opinion polls now indicate that the majority had shifted in favour of reform. The next step must be to convince a majority that the necessary reforms may include some that hurt that very same majority.

Kevin Featherstone pressed Nicos Christodoulakis on his critique of the outside diktat asking for cuts across the board: given that they were imposed after Greece failed to deliver, how can the world trust that Greece will be able to take the necessary steps without such outside pressure? Nicos Christodoulakis admitted that there was domestic failure, above all around 2008-09 when the opposite of what was publicly announced was actually done. Once reforms became inevitable, the government, rather than negotiate feasible terms and constructive conditions, simply surrendered to lenders that sought quick fixes. Until this very day, there is no growth strategy

deserving the name. For instance, not a single hour of ministerial discussion has been spent on how growth could be revived; €26 bn funds for infrastructure investment that the European Council granted two years ago have not been spent even though they could provide a massive stimulus, equivalent to 11% of Greece's GDP. But despite all that, legitimacy requires the Greek government to mend their ways and take charge.

This was taken up in the discussion, starting with two observations. First of all, funds are available, from member states but also from the European Investment Bank as Jim Rollo had called for earlier; and second, Greece is not alone in failing to use these funds for kick-starting and developing the economy. If so, should programme countries not be monitored in their investment behaviour and their (mis-)management of capital movements, while right now they are only monitored on failings regarding their fiscal behaviour. Another challenge concerned the assessment that nothing has been achieved by the past administration, given that the primary budget deficit of 10% in 2009 was brought down to 2%, an adjustment that according to the IMF database on fiscal is unprecedented. Nicos Christodoulakis thought this consolidation, while unprecedented, was helped by an extraordinarily large deficit before.

The question from the audience whether there is any role for outside intervention beyond financing the adjustment was negated by both Antigone Lyberaki and Nicos Christodoulakis. Not at this stage, the domestic government must be seen as being able to set priorities and see them through on their own so as to restore confidence and credibility. Outside help cannot substitute for domestic mobilisation for change. Jim Rollo saw a role for trade and world market integration. This requires a sequencing of competing on price and then on quality. The former can be achieved more quickly by bringing labour costs down, while the production of quality requires more time. It will also be more painful and harder to achieve than the Germans are ready to admit today, even though they should know better given their own experience in the early 2000s when mass protests against the Hartz reforms almost toppled the government.

6. Conclusions[9]

The lessons from our discussions at this one-day conference do not give much reason for optimism. Yet a few realistic suggestions for the future are worth teasing out. The diagnosis that this is a sovereign debt crisis prevails in practice. This diagnosis suits the creditor countries rather well. By contrast, this conference shared the consensus that sovereign debt played only a secondary role. Even in Greece and Portugal sovereign debt can at best explain a national crisis. It is the integration of European bond markets that amplified their public debt problems and triggered a feedback loop between bank balances and government finances across the Euro area. The most immediate practical question for economic governance of the Union is therefore how the circuit between private and public debt can be broken.

The unfolding dynamic of a financial-fiscal crisis has pushed the ECB into the role of having to do some of the work that fiscal authorities normally do, such as recapitalizing national banks, with parliamentary scrutiny and approval. This uncomfortable role has made the central bank in turn threaten governments with a non-accommodating stance if they do not engage in fiscal consolidation. The perverse outcome is a kind of chicken game in which the one loses who first blinks in a game of mutual destruction. It is the chicken, though, that prevents destruction by cooperating. The general tenor of this conference was arguably that the ECB should play the chicken and signal an accommodating stance.

Credit-fuelled booms, current account deficits and the concomitant problems of private debt have now been recognized as an area for EU surveillance. But the Scoreboard for the new Macroeconomic Imbalances Procedure cannot and must not be the trigger for a quasi-automatic process of tightening surveillance at the end of which a government can be fined. In any typical crisis country, the multitude of indicators is likely to produce an ambiguous and hard to interpret picture of the risk potential. So the Scoreboard is at best a starting point for putting together a plausible 'story' about its particular macroeconomic situation, to quote Paul De Grauwe. But the intransigence of the surplus countries has not been helpful in taking such a pragmatic approach, even though they have more room for manoeuvre and are actually the inadvertent beneficiaries of capital flight out of the countries under pressure. The only hope here is that enlightened self-interest will eventually prevail and the minimum solidarity come forward that most attendants at

[9] The following are obviously my conclusions and should not be attributed to any participant or co-organiser of the conference.

this conference deemed necessary if the Eurozone is to survive.

But it would also be misleading to blame everything on the financial crisis and take comfort in the fact that it all started in U.S. subprime mortgage markets. Even before that, governments in Western and Northern Europe let social imbalances evolve despite a relatively benign economic climate, in an attempt to bring down unemployment rates at no extra fiscal cost. Interestingly and reassuringly, most governments in Central and Eastern Europe did not reduce income support for those of working age to the same extent as, say, Finland, Germany and Sweden. Even the much criticized Memorandum of Understanding for Greece reveals some sensitivity of the troika to the fact that salary and pension cuts as well as tax increases must be progressive and not across the board. While the EU's welfare trilemma is obvious and heavily biased towards fiscal sustainability and increasing employment, some redress towards fairness is conceivable as well.

Economic governance of the European Union and within its member states was predicated on a growth model that fundamentally believed in markets to lift all boats and macroeconomic stability to be a minor concern. For evidence of this belief, one can point to active labour market policies or to the permissive attitude towards private credit and debt creation. The tone has now changed noticeably. In proposals of the European Commission, or the OECD for that matter, regarding financial regulation and labour market reform one can detect, with a bit of effort, social policy concerns that were not there before. Does this mean that the reference model for European policies is no longer the highly mobile and financially literate individual? The majority of European citizens live in communities they prefer not to leave. They regard their biggest investment, namely acquiring a family home, not primarily as a financial transaction.

There is a lot of talk about reconnecting with the concerns of EU citizens by EU policymakers. What if the protection of these concerns requires some compromise on certain forms of market integration? This is an uncomfortable question for economic governance of the Union. But since market integration is only a means to an end, it is not one that can be easily dismissed.

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Managing imbalances in the Eurozone

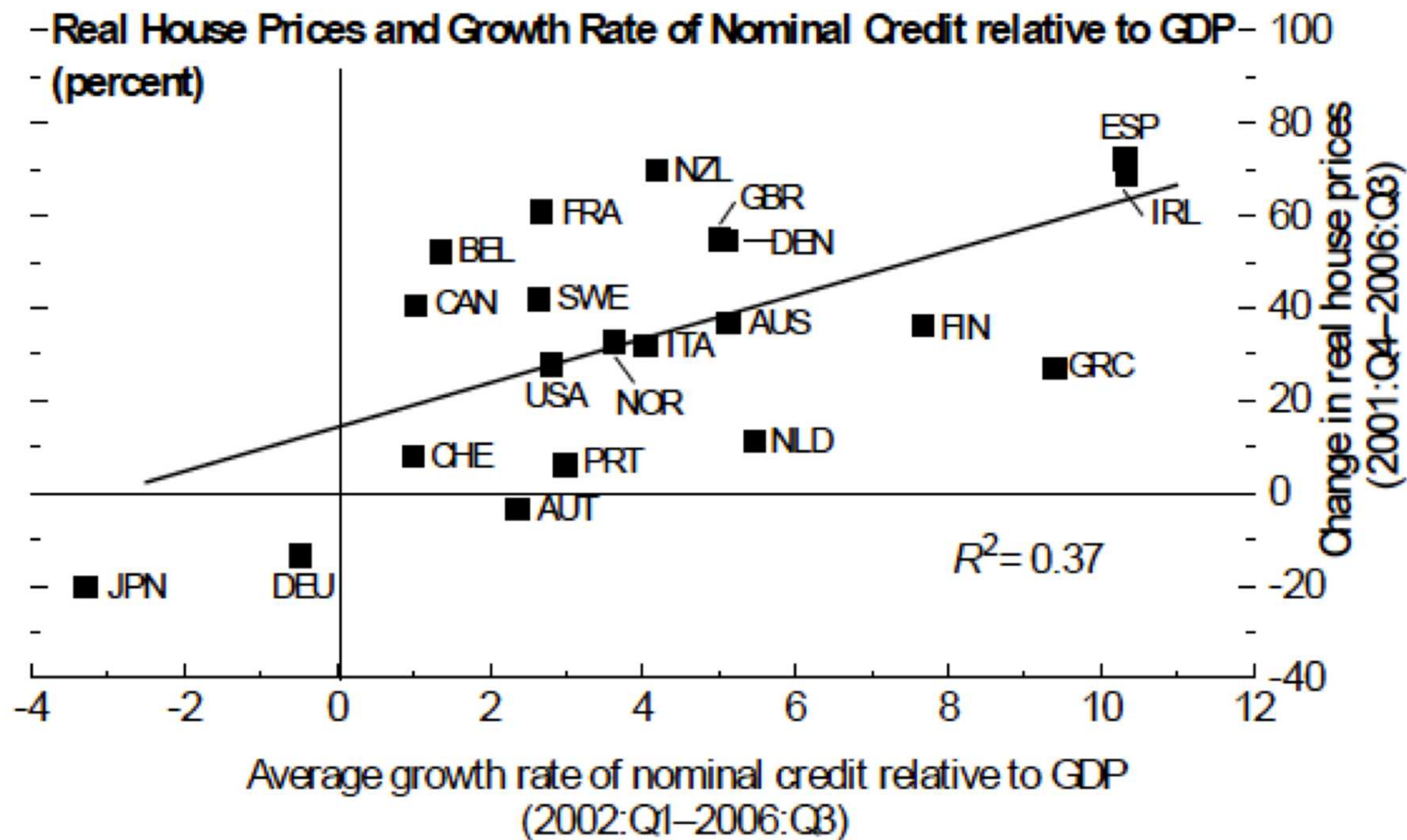
Paul De Grauwe

- Macroeconomic Imbalance Procedure (MIP) has been constructed for a particular type of crisis that has occurred in the Eurozone
- But will future crises have the same features?
- Would present MIP shield us from alternative future crisis dynamics?

Prototype of crisis: Spain

Take case of Spain before crisis:

- Excessive bank credit
- Leading to bubble in real estate market
- And a consumption boom
- With excessive debt accumulation by private households
- and large current account deficit



Source: Kannan, et al. (2009)

Two issues

- Is this the only type of crisis that can hit the Eurozone?
- Even if we get this type of crisis in the future will it be recognized

Other types of crisis possible

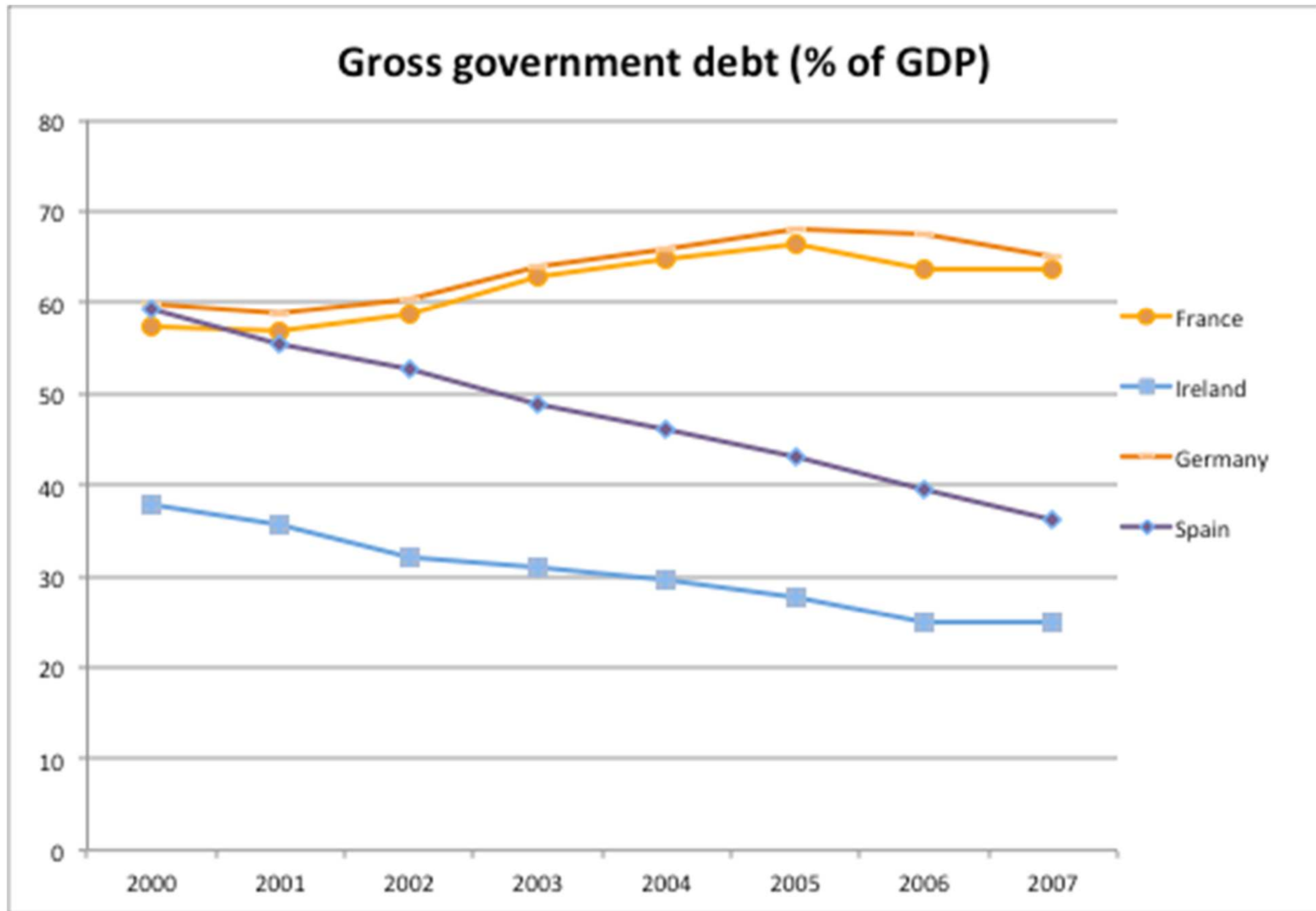
- It is possible that boom and bubble develops without significant current account deficit
- Example today: Sweden
  - Export boom due to undervalued currency leads to bubble in housing market
  - Crash is likely leading to recession and banking problems
- The scoreboard will have difficulties recognizing this, as indicators will point in different directions
- In a nutshell: scoreboard too much influenced by the most recent build-up of imbalances as if this is the only possible one

Will we recognize the crisis?

- Even if it is the Spanish-type crisis
- would that lead to unequivocal signals that lead the Commission to trigger the Alert Mechanism and later the Excessive Imbalance Procedure?
- Countries with imbalances like Spain typically have large budget surpluses, high growth and declining unemployment
- In other words they enjoy a good party

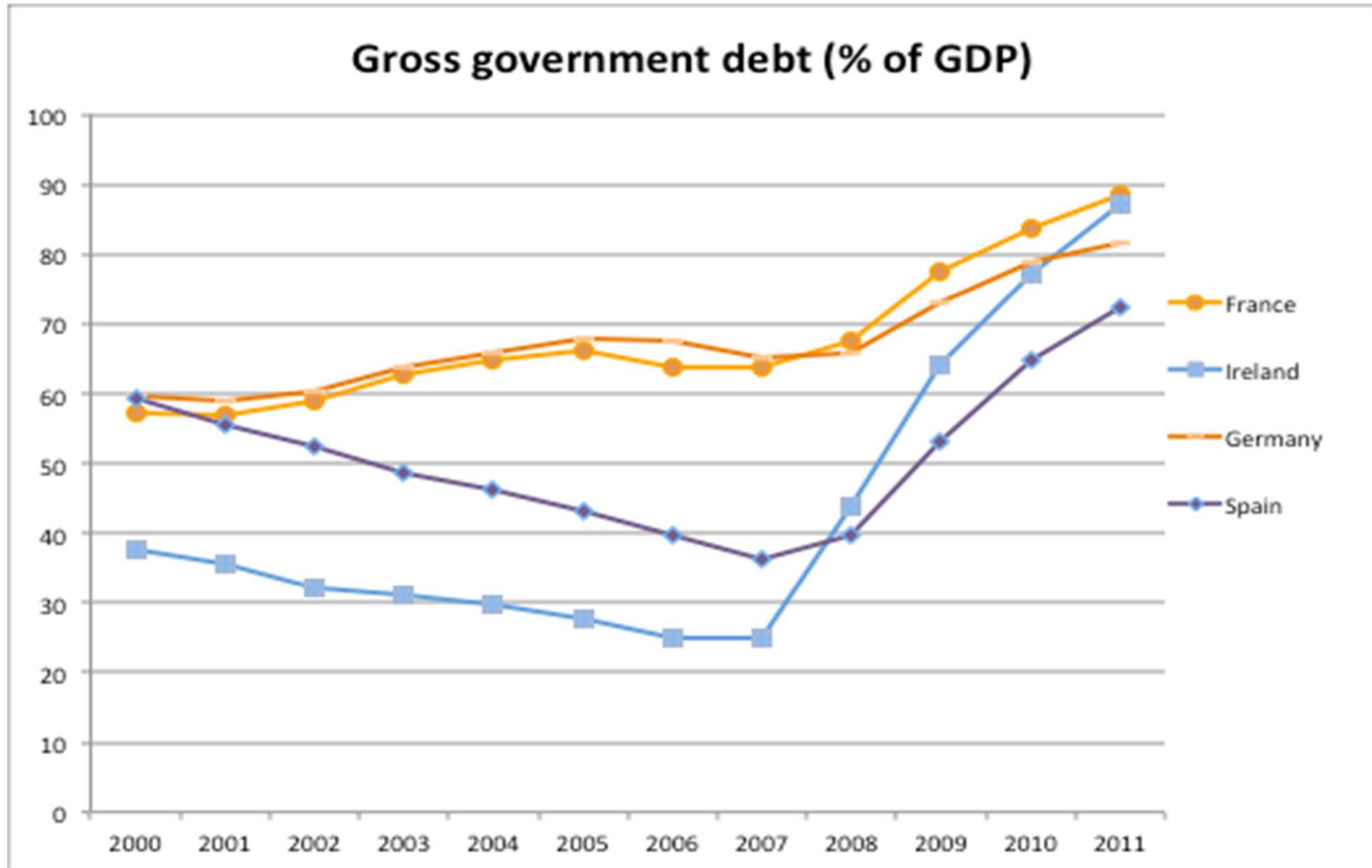
- And European Commission will have to take away the party bowl.
- That’s very difficult.
- Also because stories are being told about fundamental changes that justify high asset prices, even current account deficits
- “This time is different”-syndrome

Fiscal positions in real time before the crisis



- When seen in real time the spectacular fiscal improvement in Spain and Ireland works as a framing device in which we interpret the less favourable numbers (current account, bank credit development) in a benign way.
- “When budget improves so spectacularly the current account cannot be a serious problem”
- This will also be the case in the future.
- It is only when we see the end result that this framing effect disappears

Ex post, everybody says: of course



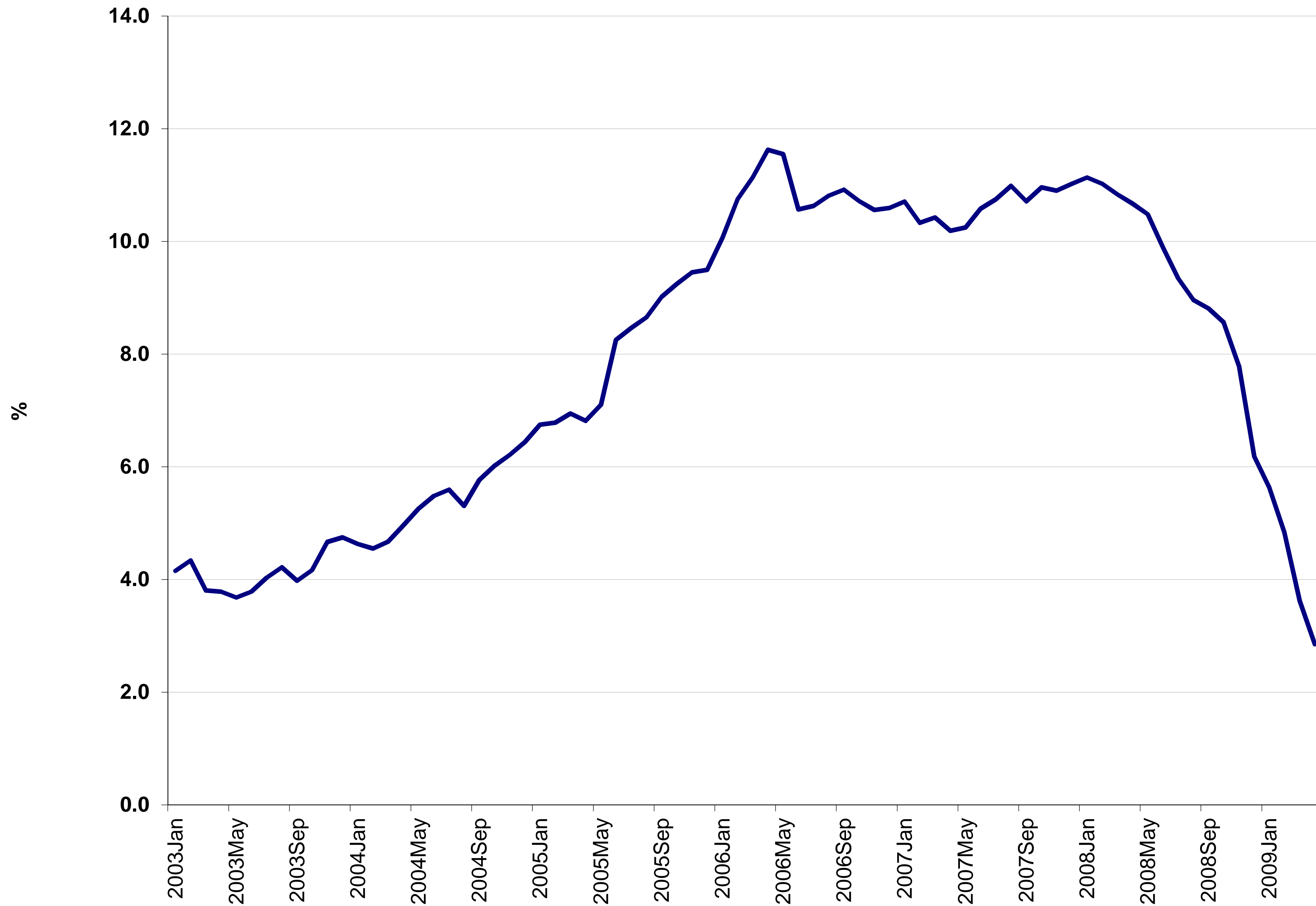
But let us assume we will avoid framing effect in the future

- Once an imbalance is identified and an excessive imbalance procedure is started
- what instruments do authorities have to correct these imbalances?
- Take case of Spain again during the boom.
- How do you stop a credit-fueled boom?
- Answer: by restricting credit.
- National government can do little about this.

- Spain tried: Banco de España used macro-prudential control
- This, however, did little to stem the boom and bubble in real estate market.
- Only ECB can restrict bank credit, but it is supposed to look at Eurozone-wide bank credit developments

A Note

- ECB failed to contain surge in bank credit in the Eurozone prior to the financial crisis
- Prior to crisis massive expansion of bank credit
- This also made the bubbles in Spain and Ireland possible


Growth rate of bank loans in Euro area
%
14.0
12.0
10.0
8.0
6.0
4.0
2.0
0.0
2003Jan
2003May
2003Sep
2004Jan
2004May
2004Sep
2005Jan
2005May
2005Sep
2006Jan
2006May
2006Sep
2007Jan
2007May
2007Sep
2008Jan
2008May
2008Sep
2009Jan

Do governments have right instruments?

- This leads to problem of the instruments the government has to end the party
- Government has very few instruments
- Only macroeconomic instruments available are fiscal policies
- Countries experiencing credit-fueled boom show surpluses in government budgets and declining debt-to-GDP ratios (see previous figures)
- It is very difficult to force a government with surpluses to have even bigger surpluses

Supervisors and ECB left off the hook

- What is left unspecified is role of supervisors and central bank
- In general the whole imbalance procedure is based on assumption that governments are at the root of the imbalances
- While the main cause of the Spanish-type imbalance has a monetary financial origin
- that government does not control
- But supervisors and ECB do

- As a result, these supervisors and ECB are left mostly outside the excessive imbalance procedure
- while they should be at the center of it

Conclusion

- We should have no illusions: the MIP will not prevent future crises
  - Not all crises are of the Spanish type
  - Even if they are, stories will be told that "this time is different"
  - Main institutions (supervisors and ECB) that can check emergence of booms and bubbles are not involved in MIP

- Monetary union is not only about imposing rules
- It is also about solidarity and providing mechanisms of support when inevitable crises erupt
- These crises have the potential of creating multiple equilibrium
  - Pushing some countries into bad equilibria
  - Other countries into good equilibria
- This is still insufficiently recognized in the North of Europe

Table I.1: MIP scoreboard 2012 (1)

Year 2010	External imbalances and competitiveness					Internal imbalances				
	3 year average of Current Account Balance as % of GDP	Net International Investment Position as % of GDP	% Change (3 years) of Real Effective Exchange Rate with HIPC deflators	% Change (5 years) in Export Market Shares	% Change (3 years) in Nominal ULC	% y-o-y change in deflated House Prices	Private Sector Credit Flow as % of GDP	Private Sector Debt as % of GDP	Public Sector Debt as % of GDP	3 year average of Unemployment
Thresholds	**- 4/6%**	**- 35%**	**± 5% & ± 11%**	**- 6%**	**9% & 12%**	**+ 6%**	**15%**	**160%**	**60%**	**10%**
BE	-0.6	77.8	1.3	-15.4	8.5	0.4	13.1	233	96	7.7
DE	5.9	38.4	-2.9	-8.3	6.6	-1.0	3.1	128	83	7.5
EE	-0.8	-72.8	5.9	-0.9	9.3	-2.1	-8.6	176	7	12.0
IE	-2.7	-90.9	-5.0	-12.8	-2.3	-10.5	-4.5	341	93	10.6
EL	-12.1	-92.5	3.9	-20.0	12.8	-6.8	-0.7	124	145	9.9
ES	-6.5	-89.5	0.6	-11.6	3.3	-4.3	1.4	227	61	16.5
FR	-1.7	-10.0	-1.4	-19.4	7.2	3.6	2.4	160	82	9.0
IT	-2.8	-23.9	-1.0	-19.0	7.8	-1.5	3.6	126	118	7.6
CY	-12.1	-43.4	0.8	-19.4	7.2	-6.6	30.5	289	62	5.1
LU	6.4	96.5	1.9	3.2	17.3	3.0	-41.8	254	19	4.9
MT	-5.4	9.2	-0.6	6.9	7.7	-1.6	6.9	212	69	6.6
NL	5.0	28.0	-1.0	-8.1	7.4	-2.9	-0.7	223	63	3.8
AT	3.5	-9.8	-1.3	-14.8	8.9	-1.5	6.4	166	72	4.3
PT	-11.2	-107.5	-2.4	-8.6	5.1	0.1	3.3	249	93	10.4
SI	-3.0	-35.7	2.3	-5.9	15.7	0.7	1.8	129	39	5.9
SK	-4.1	-66.2	12.1	32.6	10.1	-4.9	3.3	69	41	12.0
FI	2.1	9.9	0.3	-18.7	12.3	6.6	6.8	178	48	7.7

(1) The shaded cells in the table mark values that fall outside the scoreboard thresholds.

Source: Commission services

European Institute

CENTRE FOR EUROPEAN REFORM

HELLENIC OBSERVATORY
European Institute

ONE DAY CONFERENCE

Institutions of Economic Governance for an Incomplete Union

Tuesday, 17 April 2012
Wolfson Theatre, London School of Economics

PROGRAMME

Sponsored by

Programme

9:00 Registration

9:15 Welcome Address

Jonathan Scheele (European Commission)
Waltraud Schelkle (European Institute, LSE)

9:30 Managing Public Debt: how can the interface of central banking and fiscal policy be stabilised?

The era of strictly separated monetary and fiscal policy is over. Central banks are lenders of last resort for financial institutions holding government bonds. In particular, the ECB will continue to play a role as stop-gap in the sovereign debt crisis due to the lack of a full-fledged federal budget. How can a central bank do this without losing control of its own mandate? A pressing and as yet unanswered question for the future is how fiscal policy can back up the central bank and release it from its quasi-fiscal role after a speculative attack. This step seems to be a vital precondition for growth to resume. The crisis since 2007 has seen some inadvertent innovations in this regard, which are worth reviewing.

Chair: **Waltraud Schelkle** (European Institute, LSE)
Keynote: **Adam Posen** (Bank of England, Monetary Committee)
Comments: **Gavyn Davies** (Fulcrum Asset Management), **Jeromin Zettelmeyer** (EBRD)

11:00 Coffee Break

11:30 Managing Private Debt: what policy instruments are required?

EU economic governance is arguably short of policy instruments. A single nominal interest rate that generates many different real rates is bound to create the problem of housing bubbles and current account deficits. This is a phenomenon that has been a notorious problem for economic governance in the UK, and more recently the eurozone. What kind of measures can help to keep asset booms and busts at bay? How can more stable and regionally balanced growth be achieved? Recent reforms introduced a Scoreboard to spot imbalances, but the surveillance process is skewed towards fiscal authorities and debtor countries. This session explores other means of dealing with asset bubbles and current account imbalances, which may involve the European System of Central Banks and would build on labour market institutions in member states.

Chair: **Philip Whyte** (CER)
Keynote: **Paul De Grauwe** (European Institute, LSE)
Comments: **Wendy Carlin** (UCL), **Francesco Columba** (IMF), **Alessandro Turrini** (European Commission)

Programme

13:00 Buffet lunch

14:30 Managing Social Imbalances: competitiveness at the price of more working poverty?

The structural reform agenda of the EU is not only insufficient to deal with the macroeconomic imbalances but it also risks a political backlash against further integration. The reassessment of the OECD Jobs Strategy as well as work done by the Commission suggests that reforms that increase the flexibility of wages and employment contracts can improve the competitiveness of manufacturing and export industries but contribute to the dualisation of labour markets and working poverty in service sectors. Yet, is this necessarily a trade-off? Can striking the balance be left to competition between member states or do we need more minimum harmonisation of labour contracts? How can both goals of the structural reform agenda, growth through more flexible and more regular employment, be achieved? The US and the UK experience provide relevant evidence on these questions.

Chair: **John Springford** (CER)
Keynote: **Bea Cantillon** (University of Antwerp)
Comments: **Deborah Hargreaves** (High Pay Centre), **Kitty Stewart** (LSE), **Panos Tsakloglou** (Athens University of Economics and Business)

16:00 Coffee Break

16:30 Panel Discussion: Can reformed economic governance address the long-term problems of Greece and other countries in the Eurozone periphery?

Chair: **Kevin Featherstone** (European Institute, LSE)
Panel: **Nicos Christodoulakis** (Athens University of Economics and Business), **Antigone Lyberaki** (Panteion University), **Jim Rollo** (University of Sussex)

18:00 Wine Reception

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Correcting current account imbalances: The role of labour market settings

Alessandro Turrini
European Commission, DG ECFIN

Recommendations in labour market field linked to imbalances

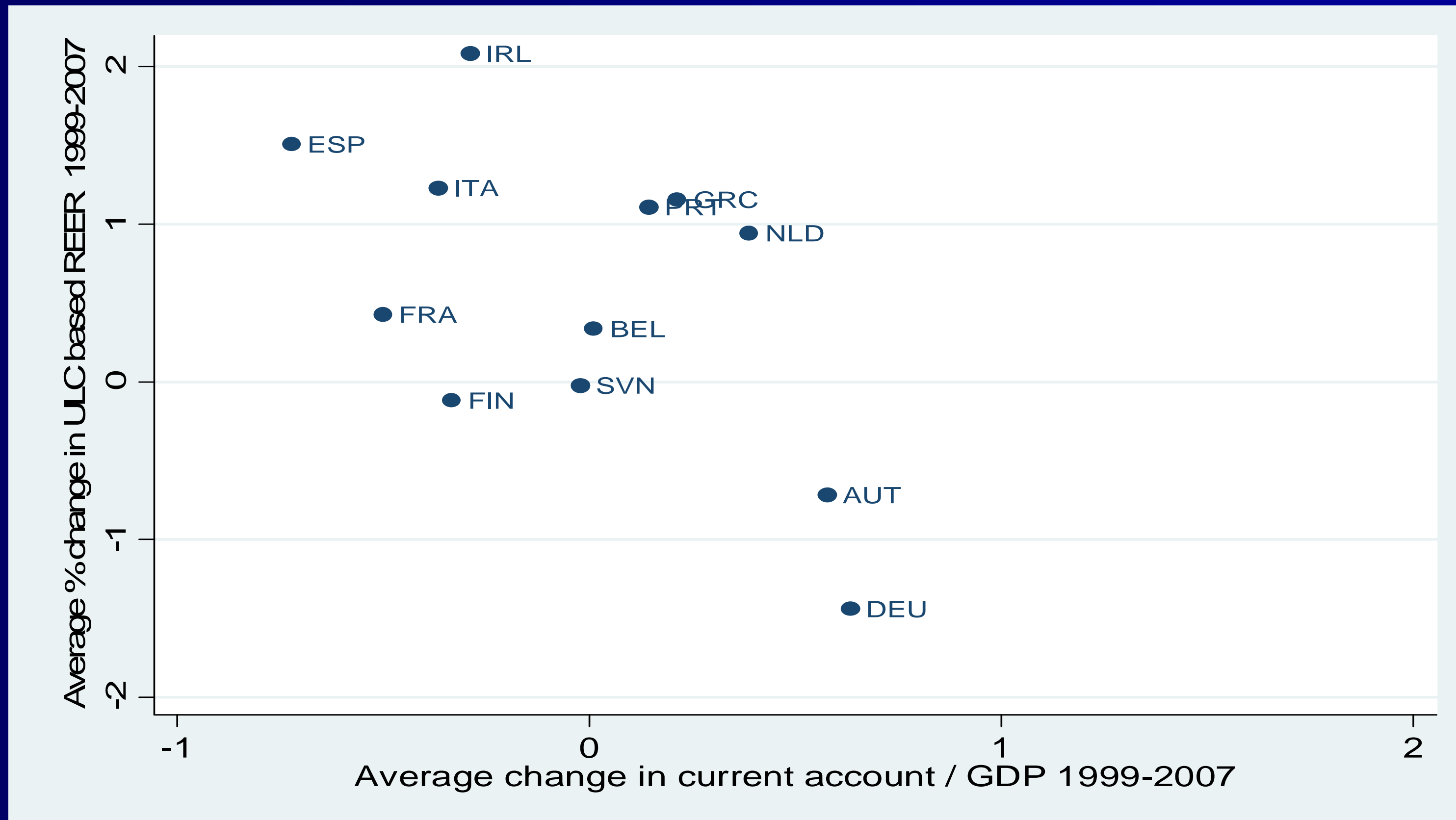
- EU semester (AGS story line)
- Programme countries
- MIP (?)

Rationale

- Durable correction of current account imbalances requires adjustment in relative prices; no nominal exchange rate adjustment within monetary unions
- There are limits to market-based adjustment
  - Relative wages respond to relative unemployment, not to current accounts
  - Downward adjustment could be slow, and unemployment protracted
- Externalities (good functioning of monetary union is common concern)

Surveillance issues

- Identification of potentially harmful developments



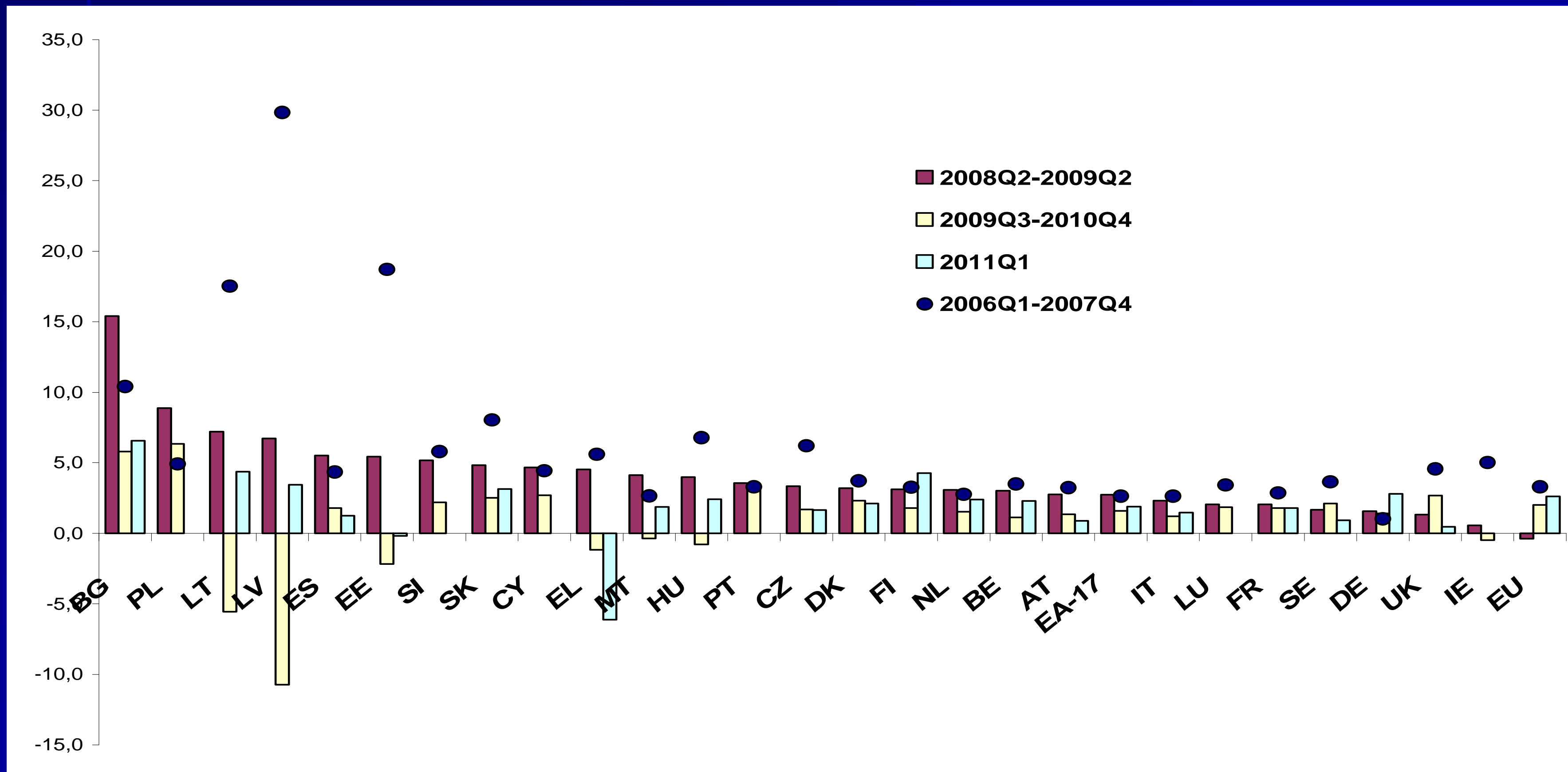
Surveillance issues

- Identification and implementation of policy response
  - to affect labour cost levels (e.g., « fiscal devaluation »)
    - Fiscal implications
    - Calibration of response
  - to enhance labour market response (wage setting reforms)
    - Role of governments vs. social partners
    - Effect on outcomes not obvious to assess

Surveillance issues

Are country experiences easily exportable?

Nominal compensation per employee dynamics before and after the crisis (average annual growth, %)



Wrapping up

- Structural aspects matter for the working of monetary unions, including concerning labour market institutions
- Externalities at play
  - « fiscal devaluations »
  - Improved market response
- Surveillance and policy implementation issues not minor
- Reform action intensified after the crisis