Imbalances, inequality & growth
Rethinking Growth Policies for Europe

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10 October, 2016
Slow growth concerns and theories

- Since the 1970s, we experience slower growth in the OECD world
- **Resource constraint**: Club of Rome (depletion of raw materials and energy is main reason for slow-down)
- **Supply constraint**: Robert Gordon (end of the „special century”; technological progress is less revolutionary)
- **Demand constraint**: Larry Summers (savings glut, low inflation, growing income inequality result in *secular stagnation*)
Uneven growth

- BRICs > OECD
- USA > EU
- Eastern Europe > Western Europe
- Germany > France / Italy
USA vs. EU countries: uneven recovery
Economic growth in US and EU (1990-2014)

**U.S. and European Union economic growth mirror one another**
Gross domestic product, in constant prices, 1990 to 2011*

*Estimates start after 2010
Source: International Monetary Fund, World Economic Outlook Database, April 2011
Central-Eastern Europe vs. Euro Zone

CEE Will Continue to Outperform Euro Zone
Real GDP, % change yr ago

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<tr>
<th>Country</th>
<th>2014</th>
<th>2015F</th>
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<td>Euro zone</td>
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<td>Latvia</td>
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<td>Czech Rep.</td>
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<td>Lithuania</td>
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Sources: National statistics offices, Eurostat, Moody’s Analytics
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<td>Cohesion policy (budget ~0.4 % of EU GDP)</td>
<td>Stronger constraints on monetary and fiscal policies, yet:</td>
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<td>• supporting long-term cohesion &amp; convergence</td>
<td>• no lender of last resort</td>
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<td>• mitigating core-periphery dynamics resulting from competition within Single Market</td>
<td>• no shared fiscal capacity to help deal with cyclicality &amp; asymmetry</td>
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<td>Social legislation preventing a race-to-the-bottom in working conditions</td>
<td>“Internal devaluation” as the only remaining adjustment mechanism</td>
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<td>This deepens core-periphery divergence</td>
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East-West asymmetry

- Imbalance linked to single market + income gap
- Eastern periphery, pre-crisis:
  - Capital inflows, subordinated positions
  - Labour outflows, demographic decline
- Crisis: CEE performs better than eurozone
- Policy reply:
  - More investment in human capital (incl. ESF)
  - More inclusive labour markets
  - Managing EU labour migration better
South-North asymmetry

- Imbalance linked to (minimalist) monetary union
- Southern periphery, pre-crisis:
  - Capital flows contribute to bubbles
  - Wage dynamics erode competitiveness
- Crisis: massive divergence within eurozone

Policy reply:
- Closer economic governance, incl. wage dynamics
- Effective MIP
- EU level financial sector regulation (BU)
- Automatic stabilisers at eurozone level
- Investment policy
Divergence in inequality developments (ES vs. DE)

Source: Eurostat, EU-SILC
Divergence in income inequality (S80/S20)

Source: Eurostat, DG EMPL calculations – Years refer to income reference years
Inequality increased in half of EU countries, incl. in a few with already high levels

Source: ESTAT, EU-SILC
Inequality changes mainly driven by increases in primary incomes (before transfers)

Source: ESTAT, EU-SILC
More equal societies withstood the recent crisis better than less equal ones

- Propensity to spend
- Social stability and reforms
- Empirical studies
- Secular stagnation?
- Less valid for catching-up MS
Social divergence in the Economic and Monetary Union

- EMU with serious design flaws:
  - single currency + uniform fiscal rules (+centralised monetary policy) without risk sharing or transnational shock-absorbers
  - instruments serving stability are much stronger than those supporting growth
  - social problems generate spill-over effects on other members of euro area (e.g. falling demand)
  - deterioration of human capital, loss of competitiveness and risk of destabilisation and disintegration

→ Need to **restore socio-economic convergence** in euro zone through #EMUreform
Conclusions

• Slow growth is a general issue in the OECD world but Europe has additional and specific problems (internal imbalances and incomplete monetary union)
• The EU’s economic challenge is not competitiveness in general but internal imbalances (and North-South asymmetry in particular)
• The weakness of the EMU recovery capacity is greater problem than the EU growth potential in general
• The EU can and will live with significant imbalances but divergence can result in disintegration and lasting stagnation
• Reducing imbalances and inequalities can help improving EU growth performance