



Centraal Planbureau

# The European Semester: Road to Prosperity or Imperial Overstretch?"

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House of Europe, The Hague

Coen Teulings  
director CPB



Draghi (and Merkel?):  
“I shall do whatever it takes to save the euro”



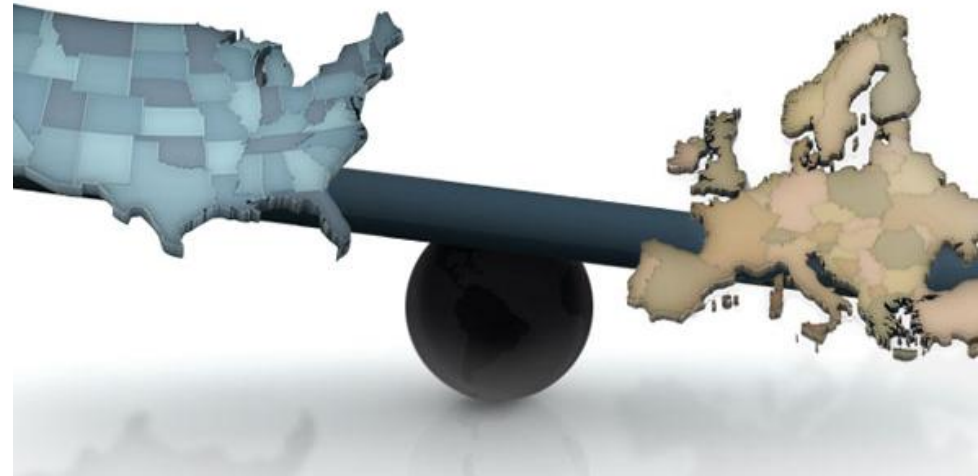
Do we realize what that is?





## US versus EU

- Economists in 1992:
  - monetary union requires political union
- American monetary union:
  - 40% insurance of member states
    - federal taxes 25-30%
    - foodstamps
    - banking union
- What in the EU? 1% !
- By the way in US:
  - strong constitutional constraints on member states
  - low state debts / high federal debt





## Banking Union

- Breaking the deadly embrace sovereigns and banks
- Most desirable form of insurance
- Capital market must continue
- Open question:  
will a banking union provide enough insurance?





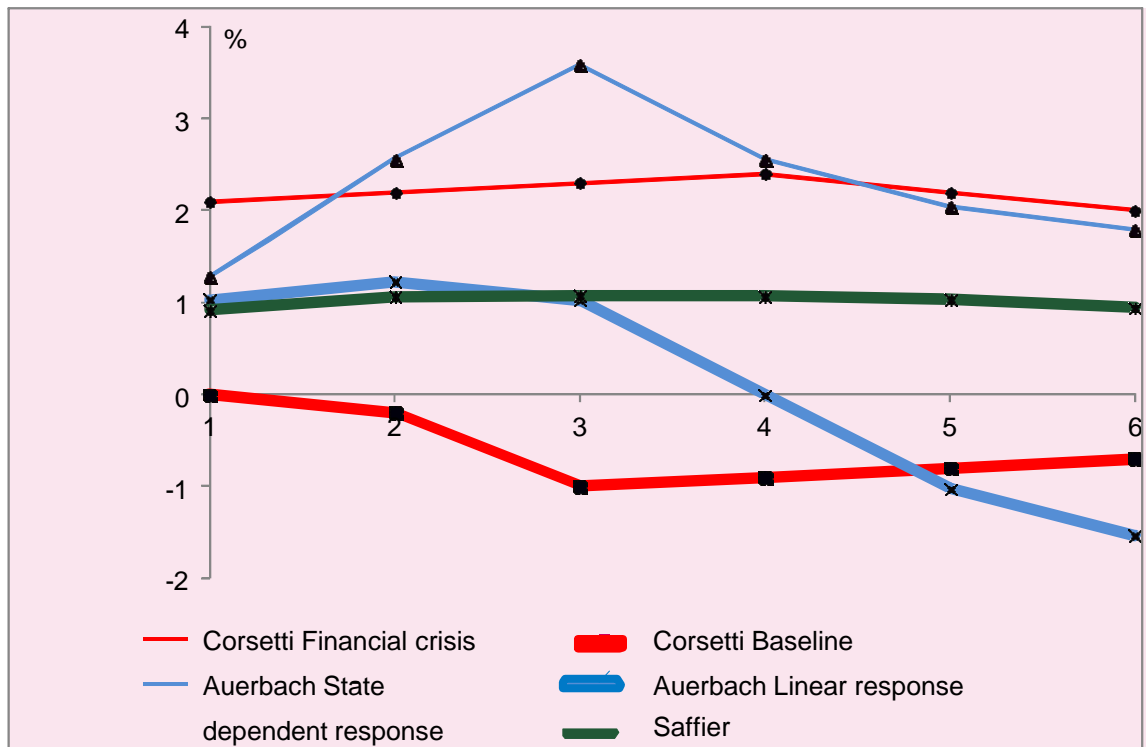
# Austerity and fiscal multipliers

- Recent macro-research  
Auerbach, Corsetti
- Multipliers generally high
- High multipliers when:
  - economy in recession
  - financial crisis
  - zero lower bound
  - for members of monetary union
- Low multipliers when:
  - high sovereign debt
  - small countries





# Fiscal multipliers





## Hold up problem

- Government debt = serious problem
  - Kumar & Woo (IMF)
  - 100 % debt = 1% growth
- Why? hold up / debt overhang
  - every asset is taxable
  - investment stop
- Fiscal policy: trade off between
  - short term stabilization
  - long term debt reduction
- Examples:
  - Greece
  - Spain: every year postponement = +5% debt/gdp







# Trust?

- Serious issue in economics
  - = commitment/credibility
  - in public debate often used as *deus ex machina*
  - included in many theoretical analyses
- Threats to trust/credibility
  - unsustainable claims (e.g. Greece)
  - inconsistent/incoherent policies (e.g. banking union)
- Dutch credibility in financial markets = good
  - does more austerity add to credibility?
  - main risk: housing market  
see Fitch on EPL and UI



## Internal imbalances and inflation

*Question: You mentioned the importance of wage and price adjustments, especially in the periphery, and given that this will probably lead to a period of disinflation, do you share the view that this means – arithmetically – that some of the core countries will actually need higher inflation in order to achieve your objective of “below, but close to, 2%”? How will you explain that to some of the more inflation-phobic populations in the core, if you share this view?*

**Draghi:** I think that the discussion here is like the one we are having as regards the rebalancing of growth. I think we will have to have rebalancing, with an inflation rate for the euro area which is below, but close to, 2% in the medium term. **And this rebalancing should be achieved, ideally, without inflating the good performers.** In a sense, I would say that this discussion is like the one where people say that we have low growth in certain areas because the best performers are actually exporting everything, so they should expand domestic demand to absorb some of the supply coming from the other countries. Again, I think the solution would be to make all countries as competitive as the most competitive performer, rather than trying to bring the best performer down.

*Question: Can you still reach your “below but close to 2%” goal? If everyone is at 0.5% inflation, the entire euro area will be at 0.5% inflation. So, just arithmetically, don’t some countries have to have higher rates?*

**Draghi:** **No, I don’t think so. I think we can have a 2% – or below 2% – inflationary rate for the whole euro area without the need to inflate the good performers. I think it’s a very feasible objective.**

(Press conference April 2012)





## Bargaining: a chicken game





## Dutch intermezzo: Where do we stand?

- adequate structural reform
- austerity: a bit much, enforced by Europe  
combined deleveraging housing, pensions, public.s.
- good starting position for recovery



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# European semester

- Useful framework
  - \* compare constitutional rules US states
- Some technicalities:
  - \* MTO of 0.5 % structural balance
  - \* definition of structural deficit
  - \* in particular in the aftermath of a financial crisis
- This is not a mild recession!
- EC should take the lead in defining coordinated macro policy



## Wrapping up in 10 bullets

1. Stability of euro further integration, supervision, but also transfers
2. Debate is currently running
3. New budgetary framework is basically OK (some technicalities)
4. Postponing resolving debt overhang is costly
5. OMT crucial to stabilize euro
6. Dutch Coalition agreement includes much structural reform: good!
7. Austerity is costly in current situation
8. Current recession is not mild
9. Current bargaining in European Council undermines trust
10. EC should take lead in coordinated macro policy:
  - structural rebalancing and inflation
  - banking union/debt overhang
  - fiscal policy