Sustainable convergence and economic resilience in EMU

Pursuing convergence in the euro area: policy options for the EU and Member States

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Relevant findings of IMF study

• A lack of convergence on many fronts:
  • Nominal evolutions: boom bust (Walters' effect -1986)
  • Real convergence fluctuating: persistent effects of nominal developments, productivity diverging in EA12 since joining EA
• Increased concordance (timing) in business cycles and a fluctuating one in financial cycles, with
  • 1/ different amplitudes
  • 2/ Germany financially ‘a-cyclical’ (more research needed)
• Convergence depends on (and calls for)
  • 1/ structural reforms at national level: boosting productivity growth in lagging economies ;
  • 2/ completing the EMU architecture: stronger national and EA fiscal policies; further deepening of Single Market; Financial Union and prudential rules
Sustainable convergence: key issue for the Commission

- Social Convergence => European Pillar of Social Rights
- High-level conference on Convergence last November
- ECFIN recent Quarterly Report on the Euro Area (QREA 2017/3)
  - Similar conclusions on how to achieve ‘sustainable convergence’
  - It looks at convergence as a multidimensional concept (nominal, real, cyclical, social) and at the many interactions among the various aspects
  - It also reports that convergence towards resilient economic structures is necessary condition to realise the other dimensions of convergence in a sustainable way
- A 2017 note to the Eurogroup on ‘Resilience in EMU’
Social Convergence

• The European Pillar of Social Rights was endorsed at the highest level during the Social Summit for Fair Jobs and Growth in Gothenburg in October 2017.
• The Pillar sets out a number of key principles and rights to support fair and well-functioning labour markets.
• This is also essential for building more resilient economic structures.
Economic resilience: A pre-condition for stability and convergence in EMU

- The economic and financial crisis transformed shocks in deep and long-lasting economic downturns, thereby endangering the **stability of the euro area as a whole**.
- **Economic resilience** refers to the **ability of the country to avoid or withstand a shock and recover quickly** to potential after it falls into recession.
- Resilient economic structures **prevent** that economic shocks have **significant and persistent effects on income and employment levels**. Thus they can reduce economic fluctuations.
- **Convergence towards similarly resilient economic structures**
  - fosters cyclical convergence and contains divergence and risks of hysteresis: labour markets, investment, and ultimately GDP
  - more effective common monetary policy
  - increases the risk-sharing
ECFIN framework for economic resilience and sustainable convergence

- (In) Vulnerability
- Shock absorption
- Reallocation of Resources
- Ability to recover quickly
- Potential growth

ADAPTABILITY

RESILIENCE (convergence toward resilient structures)

CONVERGENCE (cyclical, real, social)
May 2017 Reflection Paper on Deepening EMU – proposes a comprehensive approach to tackle key issues – December 2017 EMU package acts on some of them

1. Financial Union
   - Complete Banking Union and Capital Markets Union

2. Economic and Fiscal Union
   - Economic and social convergence
   - Structural reform assistance
   - Convergence instrument for euro pre-ins
   - Stabilisation function
   - Common fiscal stabilisation capacity

3. Institutions and Governance
   - Accountable institutions and effective governance
   - Transformation of the ESM into a European Monetary Fund
   - Integration of the substance of the TSCG into EU law
   - European Minister of Economy and Finance
### Topics of major relevance for resilience in EMU (could feature in thematic discussions of the EG)

<table>
<thead>
<tr>
<th>Vulnerability</th>
<th>Absorption</th>
<th>Reallocation</th>
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<tbody>
<tr>
<td><strong>Debt bias</strong> in corporate taxation</td>
<td>Enhancing <strong>financial risk sharing</strong></td>
<td>Barriers to product market reallocation (e.g. entry barriers)</td>
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<td><strong>Tax breaks</strong> for housing</td>
<td>Performance of <strong>automatic stabilisers</strong> across MS</td>
<td>Role of <strong>employment protection legislation</strong> in combination with ALMP</td>
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<td><strong>Supervision</strong> of European capital markets</td>
<td>Absorption capacity of <strong>labour markets</strong> (e.g. wage inertia and flexible working time arrangements)</td>
<td><strong>Barriers to labour market reallocation</strong> (e.g. human capital, pension portability, healthcare coverage)</td>
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<td><strong>Market rigidities</strong></td>
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<td><strong>Barriers to complete CMU</strong> (e.g. taxation rules, insolvency procedures)</td>
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<td><strong>Effectiveness of the judicial system</strong></td>
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*Source: Commission note to the EG: 'Economic Resilience in EMU’ (September 2017)*
The Single Market and EMU: a self-reinforcing interaction

- *Forthcoming ECFIN Quarterly Report on the Euro Area* identifies that completing the Single Market for goods and services markets may:
  - lead to a **decrease in Member States’ vulnerability** to shocks via access to more diversified export markets and sources of intermediate inputs.
  - **strengthen shock absorption capacity** through greater product differentiation and price flexibility (which contains fluctuations in output and employment).
  - **Accelerate the speed of economic recovery** following shocks by a swifter reallocation of resources, thanks to convergence to best practices in terms of market openness, insolvency frameworks and business regulations.
  - In particular, completing the Single Market in **network industries** can boost overall competitiveness given the **high multipliers and still insufficient degree of integration** in the sector.
  - **Single Market deepening part of a broader strategy to improve resilience and deepen EMU**
Thank you

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