

Beyond the short run

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INET Conference

Edinburgh October 2017

Celi, G., Ginzburg, A., Guarascio, D. and Simonazzi, A.
“Crisis in the European Monetary Union: A Core-Periphery Perspective”,
Routledge, (forthcoming January 2018).

Background and motivation

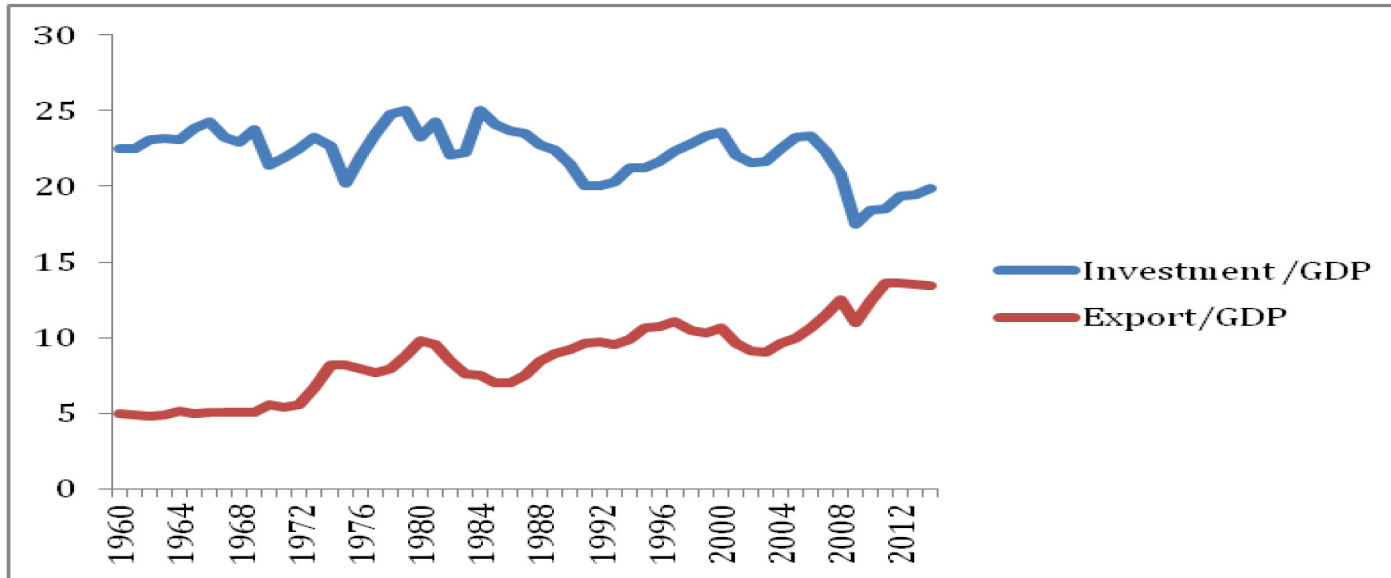
- The European project was based on the assumption that market forces could promote convergence and harmonization between and within countries.
- Experience has been different: incomplete institutional framework and weak political cohesion in the EZ finally led to multiple interlocked crises and increasing divide between groups of countries
- These crises forced (partial and belated) reforms and (mostly financial) backstops
- Weaknesses and divergences in the real economy are bound to re-create financial fragility. If permanent transfers must be ruled out, real divergence must be reversed
- Difficulty of achieving convergence between countries at different levels of development in a free trade area, with capital mobility and a common currencies, relying on market forces

Outline

- ❖ The distant roots of the crisis: a divergent path before the EMU crisis.
Interdependence between economies with different productive capabilities
- ❖ The process of integration: *Europeanisation and* globalization
- ❖ Two peripheries: the emergence of a Central European Manufacturing Core
- ❖ Short and long term policies for EMU sustainability
- ❖ Concluding remarks

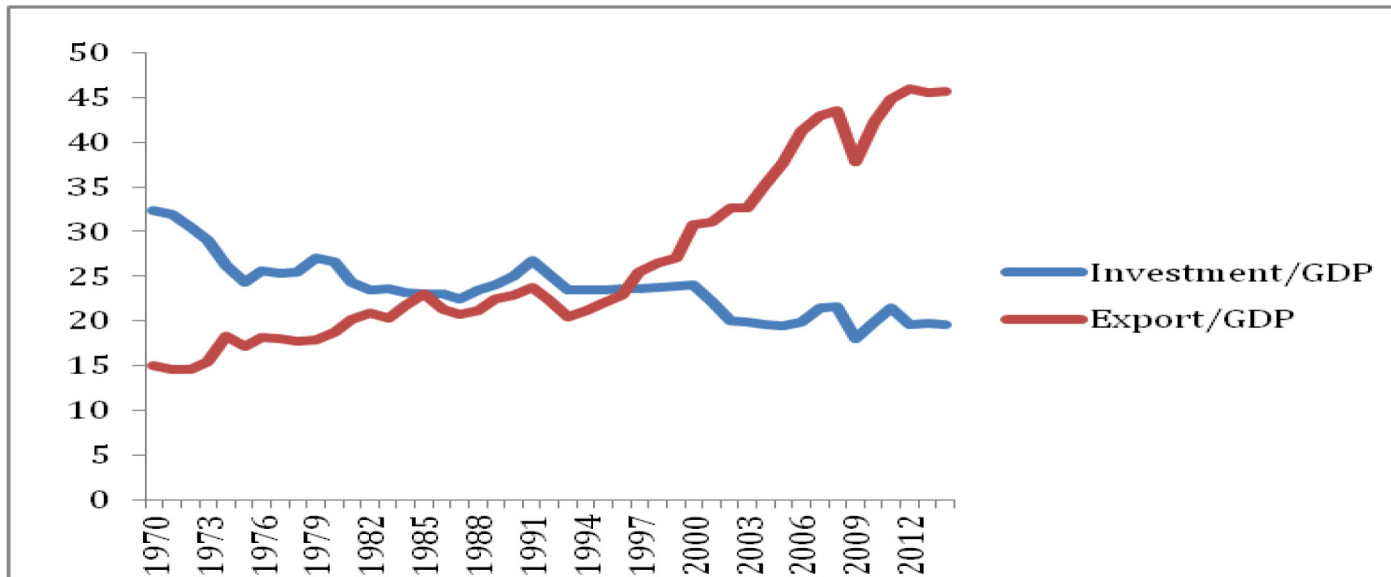
The European way to integration. Discontinuities with the golden age

- Decline in capital accumulation: from two engines of growth (I & X) to one (X)
- the transition from a “politicized” management of economic policy based on discretionality to a “**depoliticised**” **management** based on the automatism of rules (Burnham, 2001);
 - ✓ *[examples in the case of EMU: i) the transfer of control from elected officials to non elected officials (see ECB); ii) the fiscal rules; iii) the attribution of objective and thus “higher knowledge” to “technocratic expertise”]*
- the passage from the inflation phase of the 70’s to the next phase - ‘**financialization**’ - defined as a process in which financial activities become increasingly more important in the formation of the profits of the economy (Krippner, 2011).



USA

Elaboration on World Bank Data



Germany

Elaboration on World Bank Data

Europeanisation: the European way to integration

The break of the 1970s:

unequal capacity to restructure the economy (renouncing industrial policy)

different costs of disinflation (core and peripheral countries)

interdependence between core and periphery

- Two levels of de-regulation: global and European
and
- two role models: Germany: disinflation
US: financialisation

The interaction between the German and the US model led to the “European way” to global finance and monetary integration

Europeanisation: the European way to integration

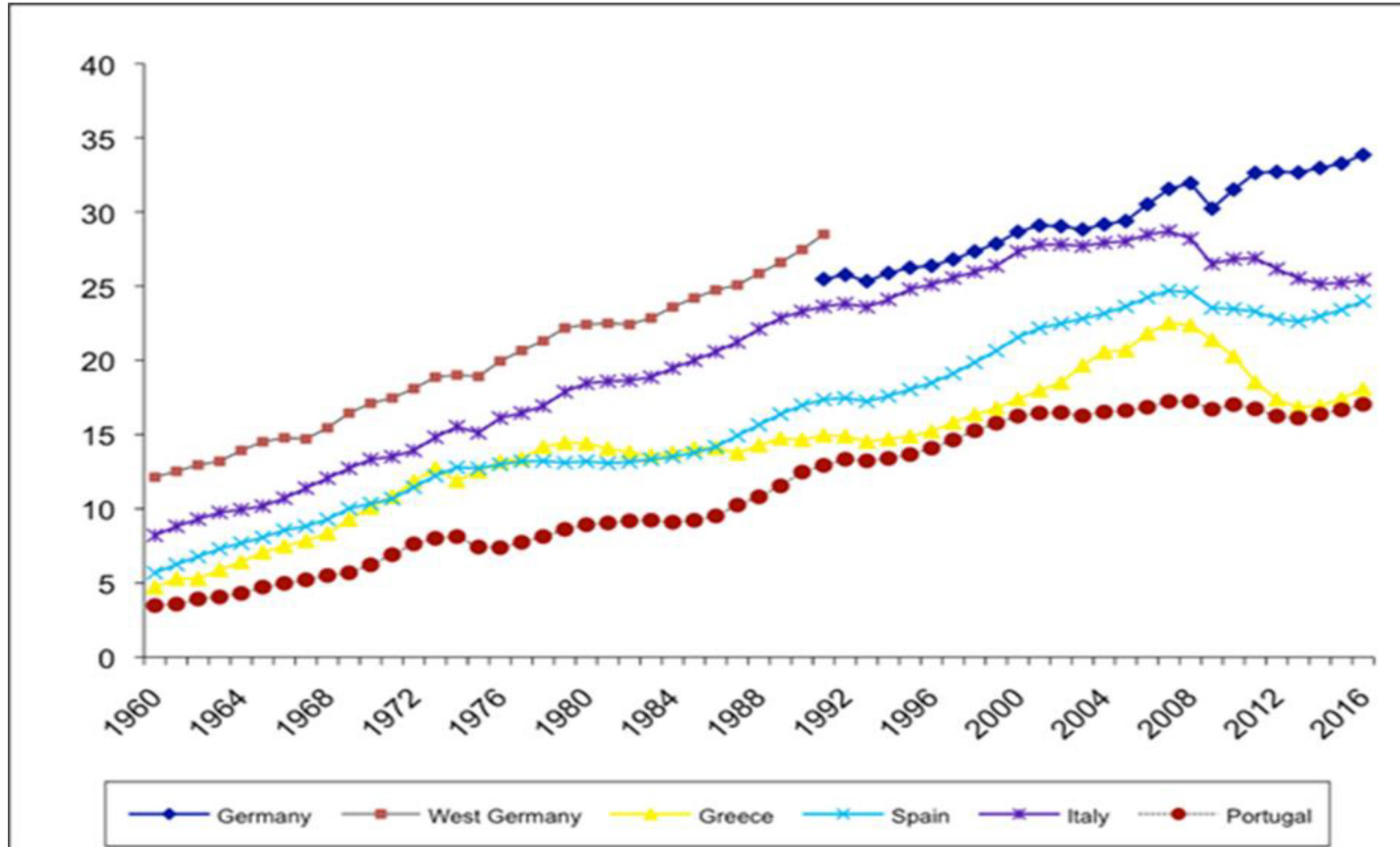
Latecomer countries.

'Early liberalization' policies prevented public investment guidance: industrial policies were redefined as policies for the guarantee of competition.

Partly as a consequence of their policies, growth in the peripheral countries fell behind in the 1980s, and the crisis associated with deregulation opened a gap in aggregate demand that was eventually filled by welfare and construction expenditure.

This 'premature deindustrialization' — restructuring without industrialization — exposed the peripheral countries to stunted growth and persistent fragility with respect to external changes even before the formation of the Monetary Union.

GDP per capita at constant prices, 1960-2016



The German trade surplus

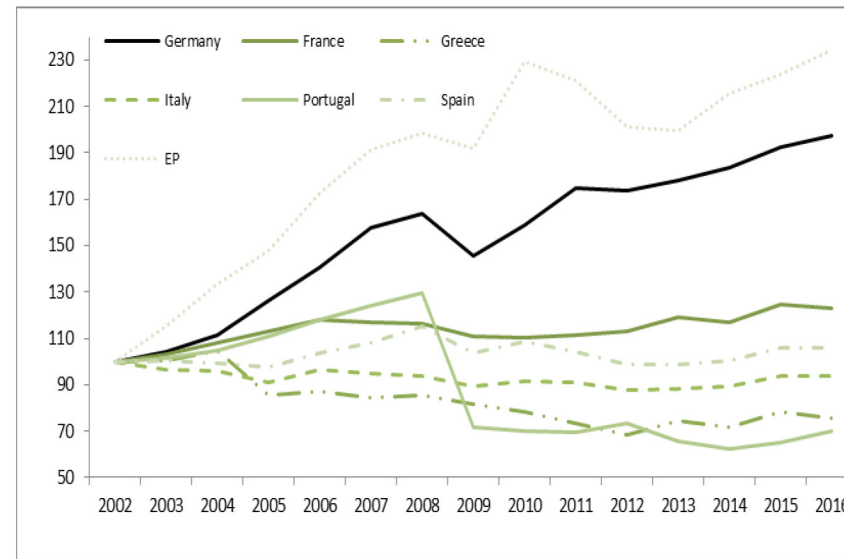
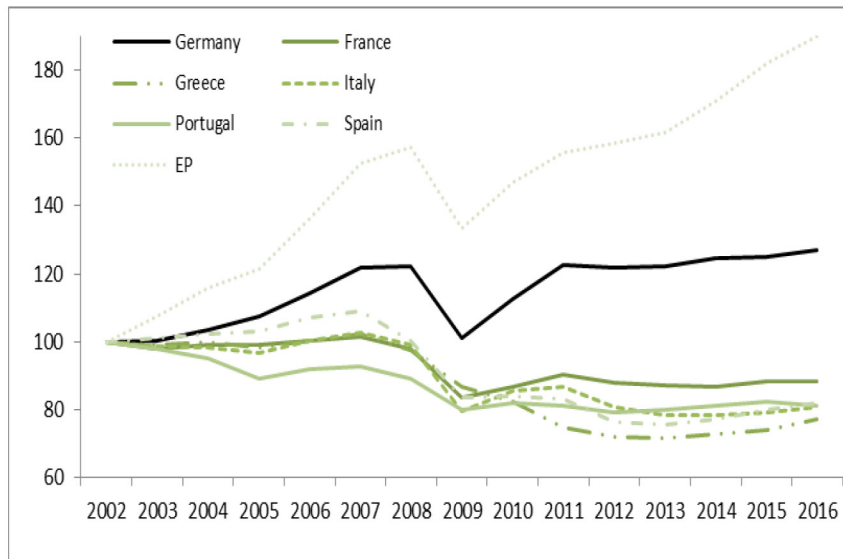
Determinants of German trade surplus: exports and imports

- (Quality) competitiveness of exports
- **increase in the share of low paid workers** and working poor
 - indirectly affects **export competitiveness** by
 - Reducing the costs of services to exporting industries
 - Increasing the real wage of “insiders”, favouring wage moderation (complementing the effects of cheap inputs from east-ward delocalisation)
 - Affects the level and the quality of **imports of consumption goods**, favouring a re-direction of imports away from SP’s “luxury” exports;
- **the de-synchronization of the German real estate** cycle from the global real estate cycle of the period 1997-2012
 - affected German competitors: since the beginning of the 2000s, the drop of house prices in Germany induced a fall in residential investments, a decline in household consumption and a consequent improvement in current account (the opposite occurring in the SP, Storm 2016).

Old and new peripheries

- The re-organization of the German industry and its east-ward extension has played a major role in the expansion of its trade surplus, favouring the emergence of a new periphery.
- Since the euro inception, the SP experienced a weakening of its industrial base
- In contrast, the EP dramatically enlarged and strengthened its manufacturing base as the result of its participation in the German value chains.
- EP manufacturing productions, closely connected with German-based firms, partly crowded out suppliers located in the SP.

Industrial production (left) and production of high tech sectors (right).
Germany, France, SP and EP, 2002-2016
(2002=100)



Source: Celi et al. (2018)

The hierarchical reorganization of the European industry

- ✓ Emergence of a “Central European Manufacturing Core” (Stehrer and Stollinger 2015) headquartered in Germany.
- ✓ Two diverging peripheries:
 - ✓ The EP becomes a location of the utmost importance for manufacturing productions enlarging and upgrading its manufacturing base – partially crowding out of SP suppliers
 - ✓ The production base weakens in the SP (and in France), and gets worse with the crisis
 - ✓ The divergent trajectories must be understood in terms of interdependent economies with different productive capabilities.
 - ✓ The story of the southern periphery cannot be told “in isolation” – that is, without taking into account the repercussions of the choices of the core, which does not imply exonerating national actors from their responsibilities

Policies for short and long-term sustainability

- Need to defuse the debt loops and to «complete» the monetary union
- If permanent transfer must be avoided, «debtor» countries must adjust
- Various options:
 - Austerity and domestic devaluation
 - «Selective» reflation: countries with fiscal space
 - Coordinated expansion (fiscal union, wage policies)
 - Development policy (industrial policy)

Targeted expansion of demand

- A German locomotive? Size and composition of “trickle-down” effects (Deutsche Bundesbank 2011)
- Coordinated expansion: the expansion of demand should be targeted to the specific developmental needs of each country.
- A new strategy geared to diversifying, innovating and strengthening the economic structures of the peripheral countries.
- even more important today, since the crisis marks another major structural break in world trade: EU latecomers can be caught in the “middle-income trap”, no longer (price) competitive because of developing countries’ catching up, and not yet capable of entering world-wide (quality) competition.

Is it feasible?

- Industrial policy at the European level: reorientation of strategy targeted at rebalancing the core-periphery divide in Europe (presently inadequate in terms of financing and focus)
 - Juncker Plan; Structural and cohesion funds; Industry 4.0
- National policies:
 - “breaking with the neo-liberal paradigm requires ... state capacity, and such capacity cannot be presumed” (Levy 2016). Decades of faith in the market and distrust in government led to neglect the infrastructure of knowledge, experience, ideas and culture required to implement a “new” industrial policy. Though it is not a “desert land”...
 - credibility of southern European governments in carrying out effective development policies. Although concern about government’s inefficiencies should be taken seriously, it should not justify inaction.
- Coordination of the various levels of intervention and
- a macroeconomic environment favoring growth: innovation (and restructuring) is hindered by a deflationary environment.

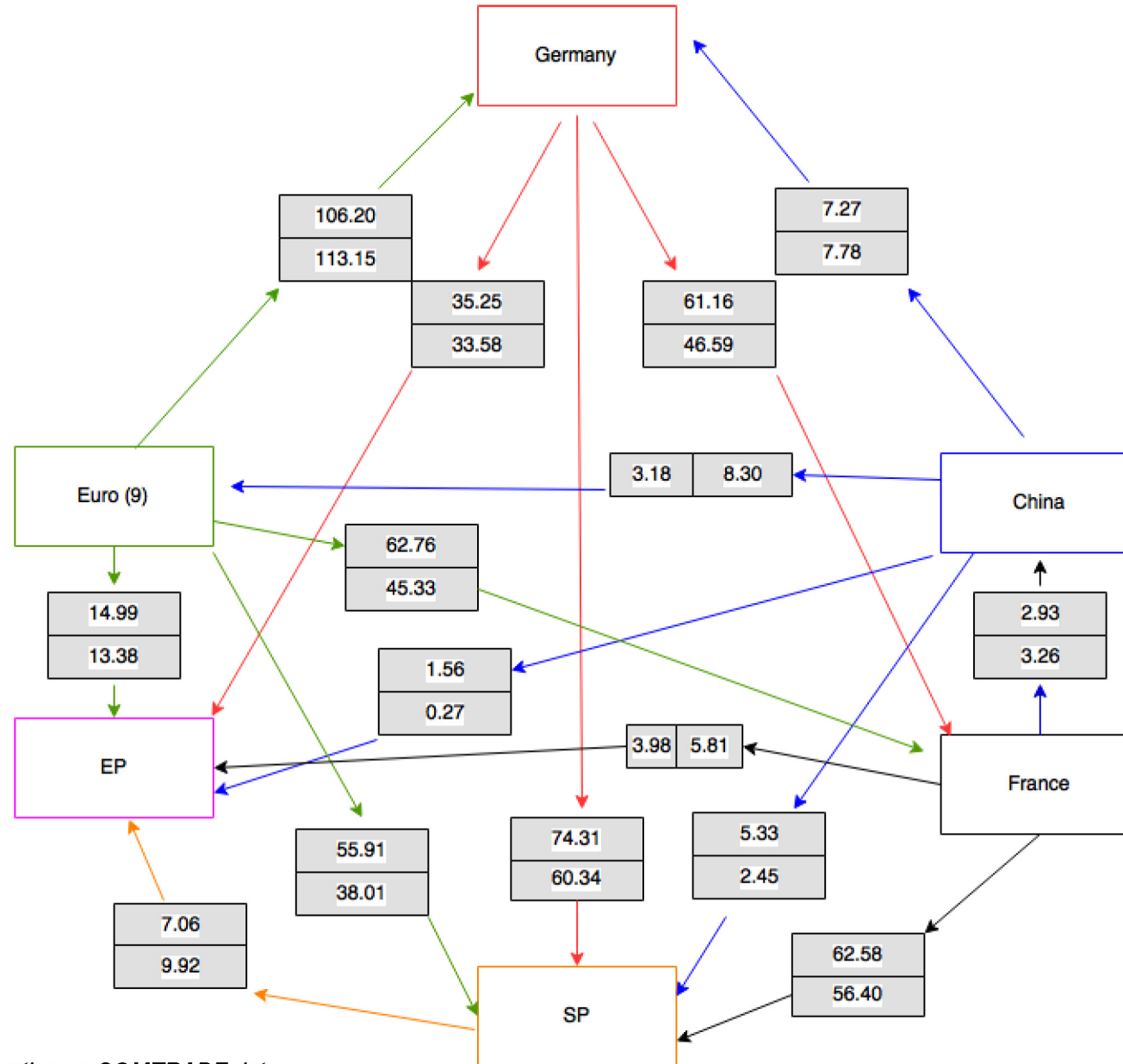
Conclusion

- A more balanced European economic integration requires a common undertaking to stop chasing (emerging economies) on low wages: this requires production upgrading, diversification and structural change.
- To this end, peripheral countries need a developmental state capable of broadening their productive capacity and increase their capabilities (to reduce the gaps between and within countries).
- This strategy is lacking in the present economic program, which reiterates its willingness to conjugate financial stability and growth, but is too concentrated on (needed) supply side, efficiency-enhancing measures in a void of strategic vision.
- The European industrial policy still relies on the idea that competition alone can guarantee a convergence. Combined with a deflationary environment, this approach cannot escape new forms of “social dumping”, or “plain destruction” of the domestic productive capacity of weaker economies.

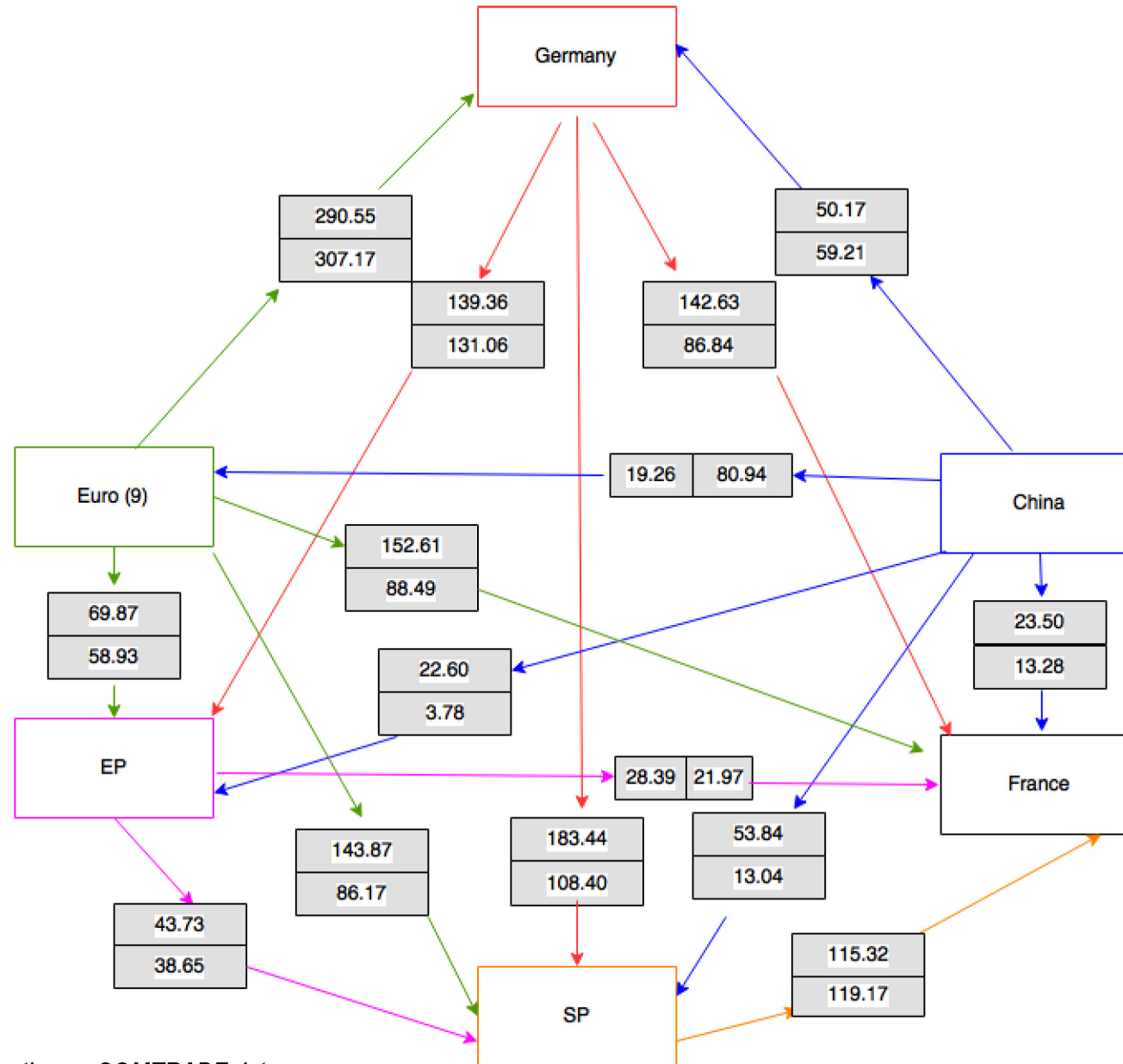
The (enlarged) European trade network (1999)

Southern Periphery (SP): GR, IT, SP, PT

Eastern Periphery (EP): CZ, HU, PL, SK

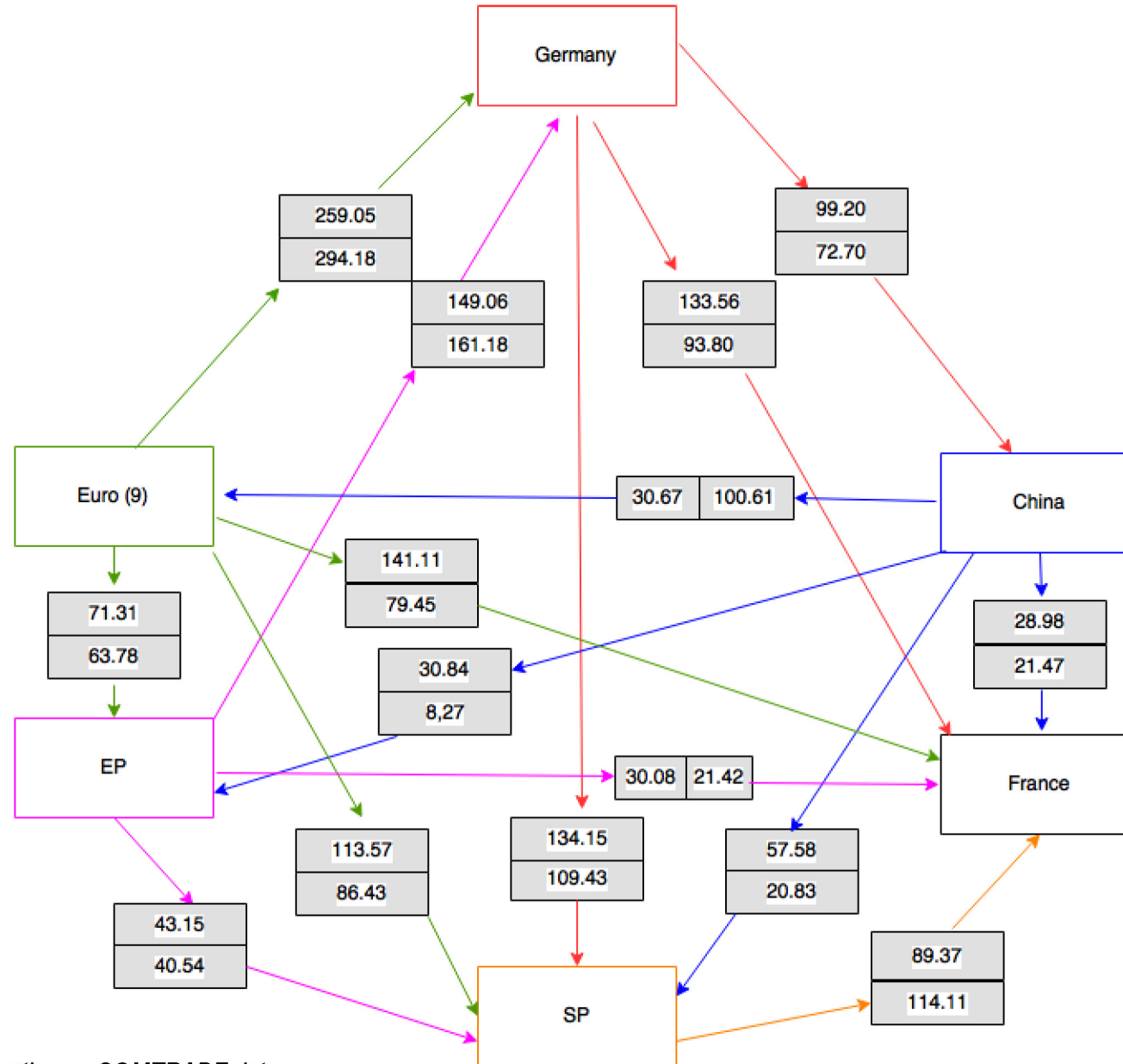


The (enlarged) European trade network (2008)



Source: authors elaboration on COMTRADE data

The (enlarged) European trade network (2014)



Source: authors elaboration on COMTRADE data