

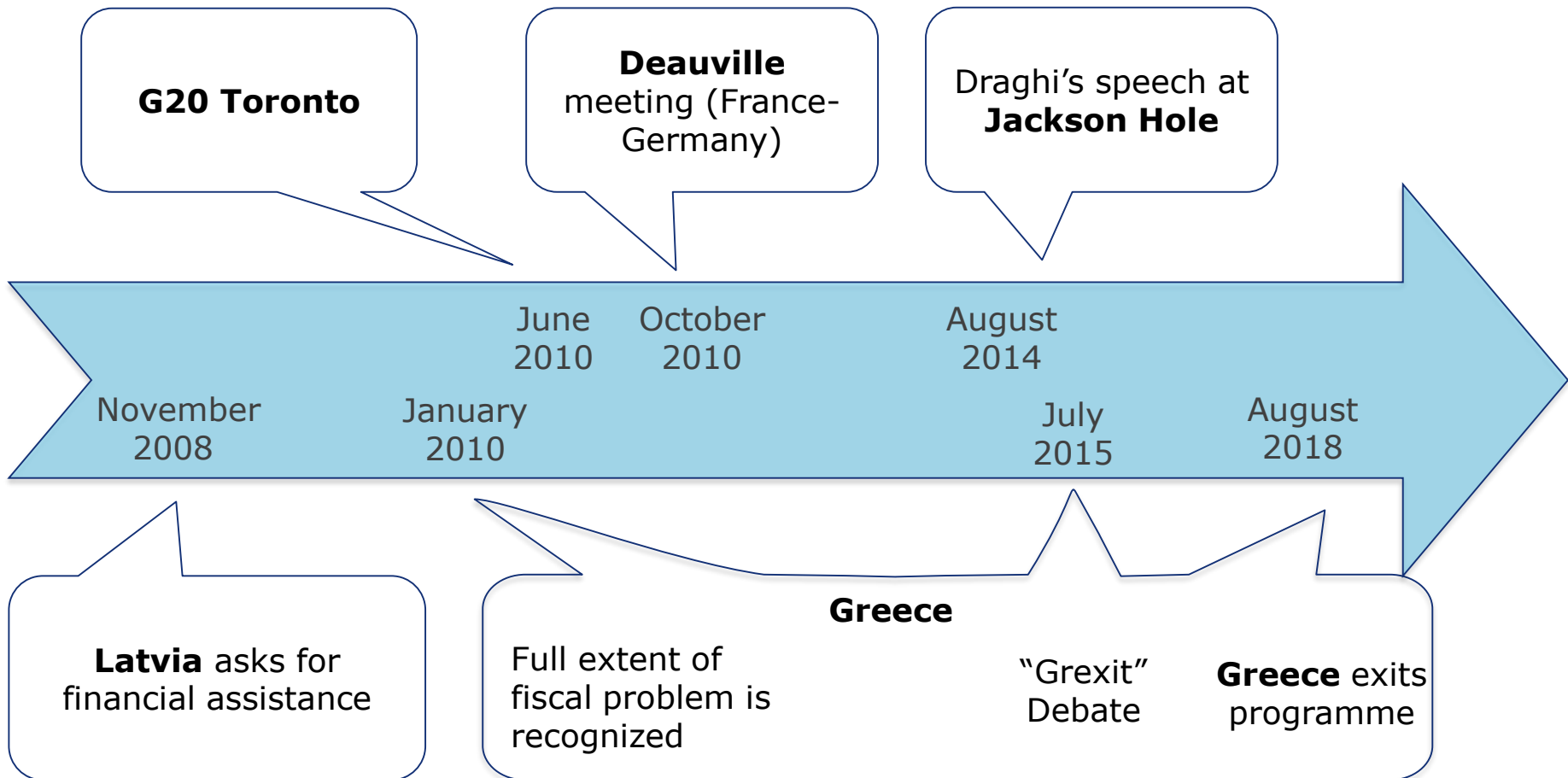


# **Economic Policy in the Rough: A European Journey**

PIIE  
12<sup>th</sup> November 2019

**Marco Buti, Director General ECFIN,  
European Commission**

# Five Pivotal Moments: better known or forgotten

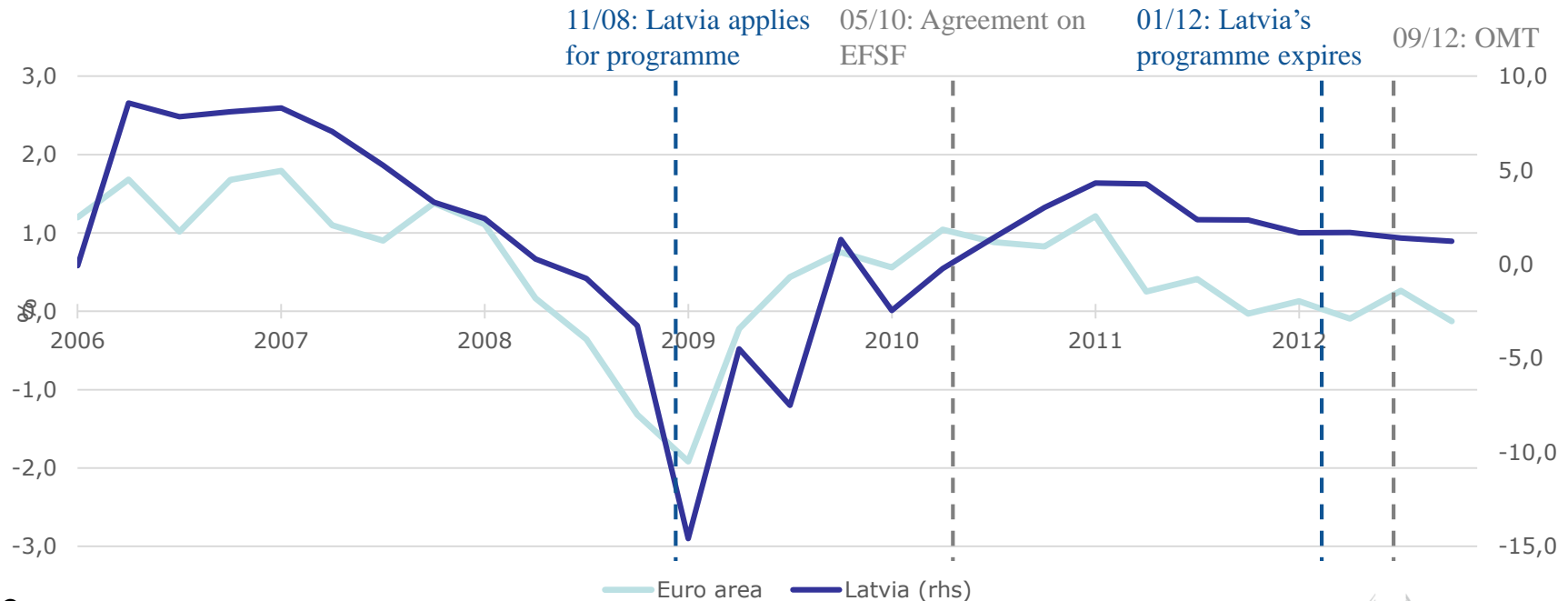


# The Baltics: a prequel of the crisis?

## Key aspects

- “Baltic Tigers”: strong performance in mid 2000s, fuelled by credit expansion
- Crisis mainly caused by imbalances, resulting in capital flow reversals
- Differing policy responses across Baltic countries → different trajectories

## GDP growth



3

Source: Eurostat

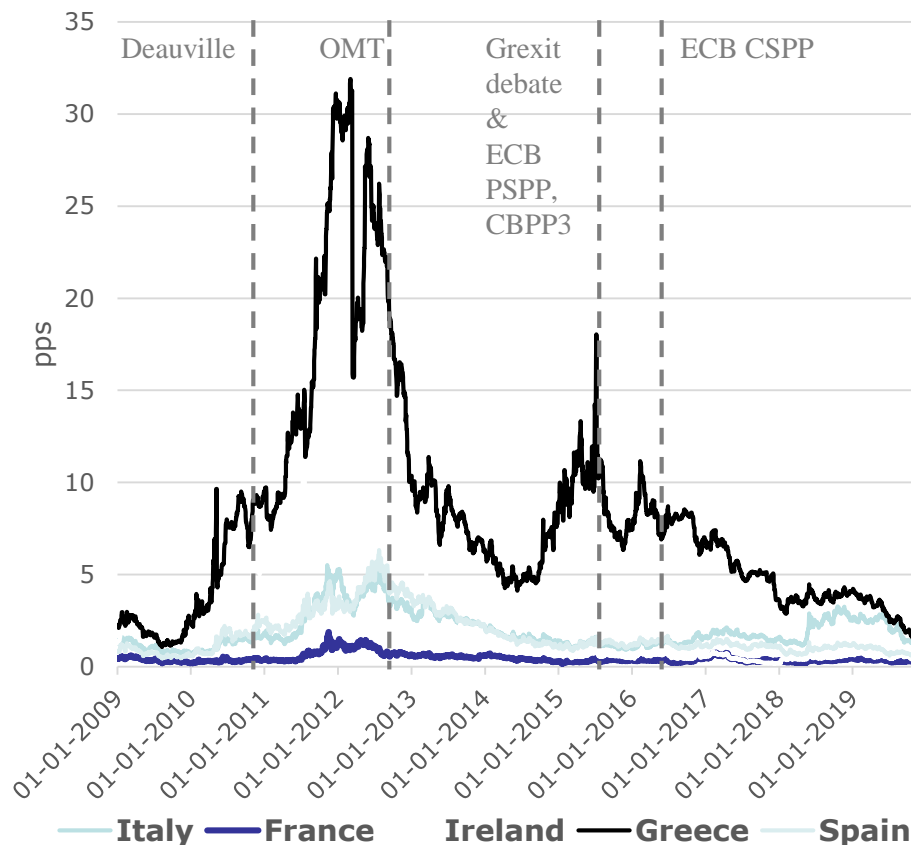
# Latvia and the other Baltics: a prequel of the crisis?

## **Lessons:**

- 1. Financial crises even in small countries can have pervasive effects and a high potential for contagion.*
- 2. Sustained capital inflows embellish the fiscal accounts. Bad fiscal accounts are often the effect, not the cause of a crisis.*
- 3. Baltics story could have been used to inform programmes for struggling EA countries and prioritising EA actions (BU).*
- 4. The exchange rate regime is more than a monetary arrangement.*
- 5. Not nominal adjustment, but deep structural reforms are key for sustained growth and stability.*

# Deauville - October 2010

## Euro area 10 years treasury bonds, spreads to the German bunds



Source: Bloomberg

## Key aspects

- Franco-German compromise between Sarkozy and Merkel catered to domestic audiences
- FR accepted tighter SGP and “bail-in” of creditors, Germany accepted future ESM
- No prior consultation of EA partners, US, financial markets or ECB
- Agreement was negatively perceived by markets and heightened contagion risk

# Deauville - October 2010

## **Lessons:**

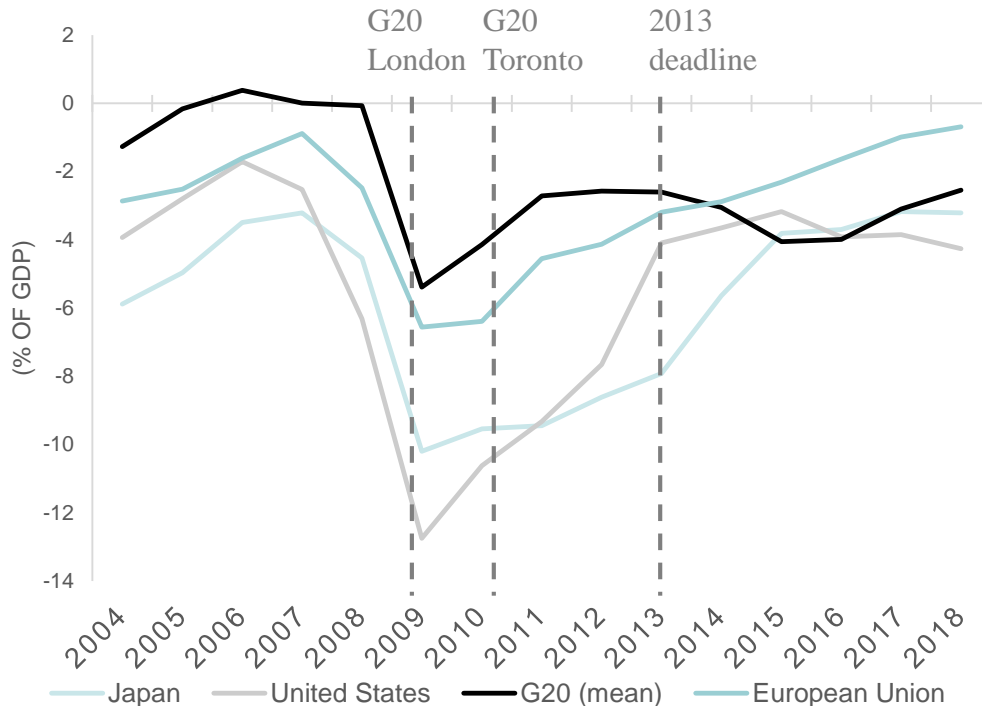
- 1. Financial markets operate according to horizontal and vertical lines: no gradual pressure on borrowers.*
- 2. Risk reduction measures, if they are not coupled with risk-sharing measures, can actually increase risk.*
- 3. EU level decisions should be insulated from domestic political economy considerations.*
- 4. Processing everything through the "moral hazard lenses" does not lead to sound policies.*
- 5. Not coordinating with partners like ECB can be very dangerous.*

“ *If you're going to restructure Greece, ... you have [to have] the ability to in effect protect or guarantee the rest of Europe from the ensuing contagion.* ”

*Timothy Geithner on Deauville*

# G20 Toronto summit - June 2010

## General government balance



Source: Eurostat, IMF WEO April 2019

“ There is a risk that synchronised fiscal adjustment... could adversely impact the recovery. There is also a risk that the failure to implement consolidation... would undermine confidence and hamper growth”

## Key aspects

- Backdrop: **unprecedented scale of both monetary and fiscal packages** agreed at previous G20 summits
- Commitment to at least **halving deficits by 2013** and stabilizing debt-to-GDP ratios, supported by structural reforms
- **Deficit countries should boost savings**; surplus countries should reduce reliance on external demand
- Commitment to **reform the financial regulatory framework** & unwinding protectionist measures

# G20 Toronto summit – June 2010

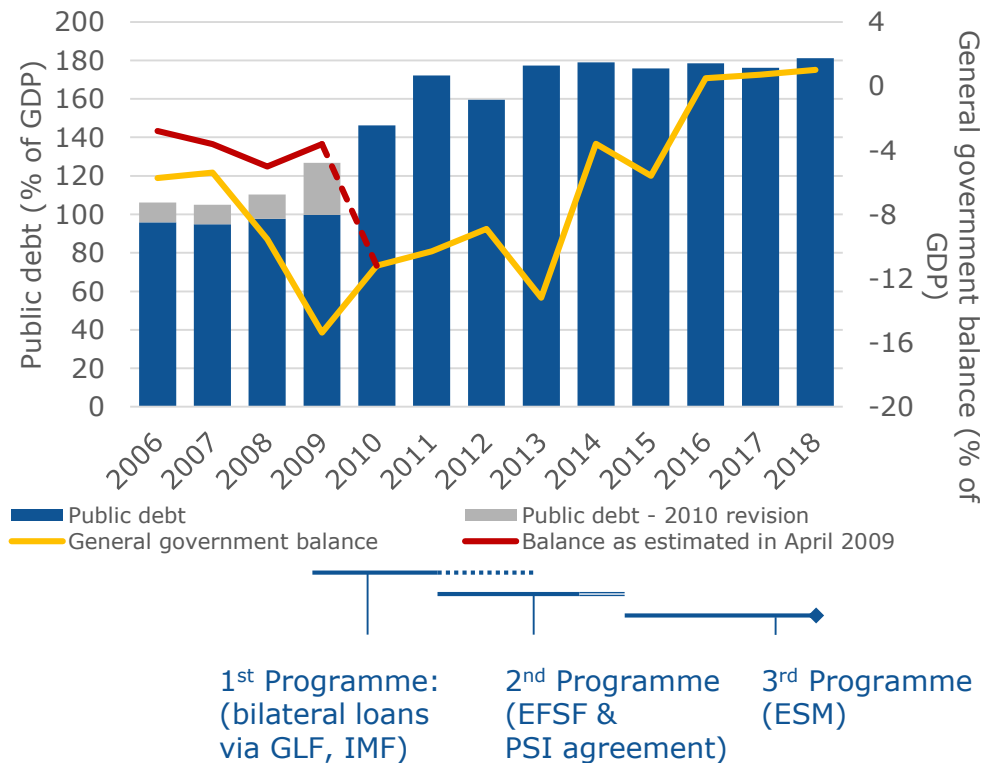
## **Lessons:**

- 1. Lost the « spirit of London »*
- 2. In aftermath of crises, early withdrawal of fiscal support can be damaging. We didn't see the increasing constraints on monetary policy.*
- 3. Need to better weigh risks and costs in the trade off between sustainability and stabilisation.*
- 4. Choosing the composition of fiscal support matters: not all measures are alike in their effects.*
- 5. Stand-still on trade protection to continue, but protectionism started to creep in.*



# Greece: a fiscal *and* a structural crisis

## Deficit and GDP growth in Greece<sup>1</sup>



## Main Events

- Revision of fiscal data in 2010: budget deficit for 2009 revised to 15.4% of GDP from 3.6% of GDP initially projected in April 2009  
EDP notification
- GLF (2010, €52.9bn); EFSF (2012, €141.8bn); ESM (2015, €61.9bn)
- “Grexit” speculation in July 2015
- Third ESM programme successfully concluded in August 2018
- ESM estimates budgetary savings from its programmes at over 6.5% of GDP. Implicit interest rate lower than in Spain, Italy, Portugal since 2012

**Programmes extended beyond austerity: key structural reforms to enhance competitiveness and growth**, e.g. in labour market, the pension system, healthcare, public and tax administration and the financial sector.

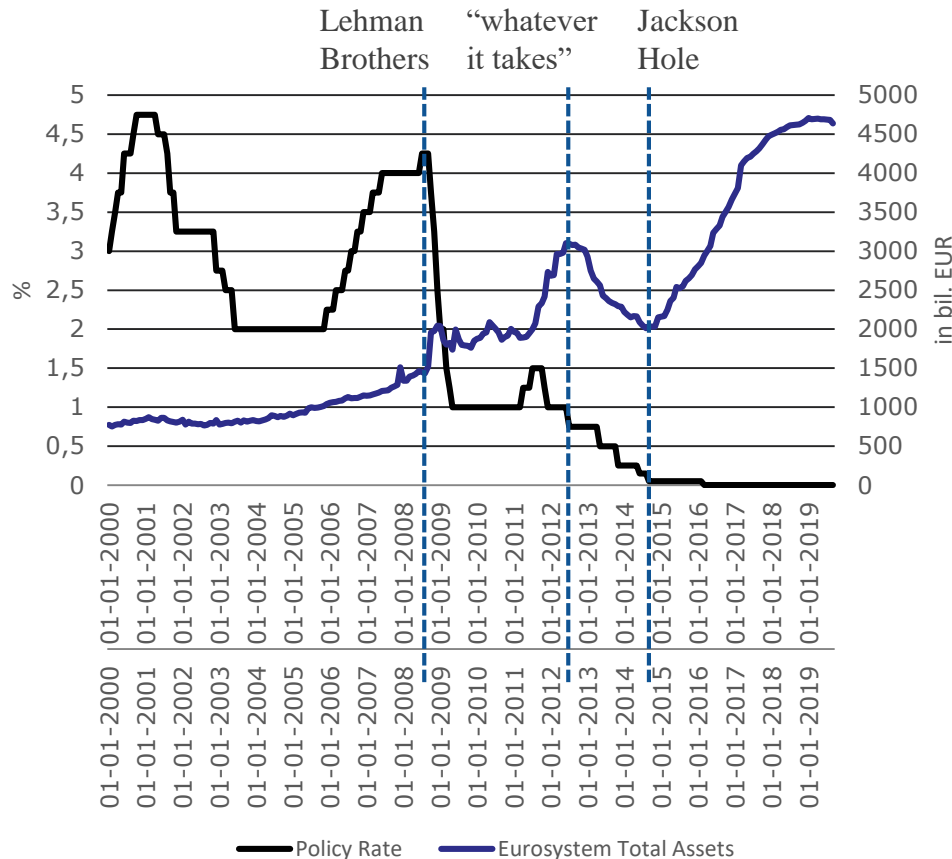
# Greece: a fiscal *and* a structural crisis

## **Lessons:**

1. Greece's fiscal crisis affected the **narrative** on other countries and on EA predicaments.
2. Crisis within EA is (also) of **structural nature**: "classic" IMF programme unlikely to succeed.
3. **Debt sustainability** needs to be addressed in timely but *sui generis* manner: politics and perceptions to be reckoned with.
4. The **EU's commitment to the single currency** project should not be underestimated, but operating under "ultima ratio" can cause costly delays for distressed countries and creditors.
5. Importance of **democratic accountability**, communication and domestic ownership. Commission cannot act as "**agent of creditors**".

# Draghi at Jackson Hole - August 2014

## Overburdened Central Bank



## Key aspects

- *Backdrop: fragile recovery; largely exhausted conventional monetary policy; increasing deflationary risks*
- *Speech was followed by unprecedented monetary policy (TLTRO, ABSPP, CBPP3), but not by fiscal expansion or meaningful structural reforms*

### Draghi warned against:

- *Risk of hysteresis effects in unemployment*
- *Being too cautious with monetary and underusing fiscal policy*
- *Too little long-term economic cohesion in EA*

# Draghi at Jackson Hole - August 2014

## **Lessons:**

- 1. Monetary policy cannot be left alone: more balanced policy mix required.*
- 2. Achieving a EA fiscal stance via horizontal coordination of national policies is very difficult.*
- 3. Excessive fiscal prudence is also a form of fiscal dominance: Sargent and Wallace "unpleasant arithmetics" on its head.*
- 4. A certain amount of risk sharing is needed in EMU: either via national budgets or via ECB balance sheet.*

“ *The risks of 'doing too little' [...] outweigh those of 'doing too much'*

**2014**

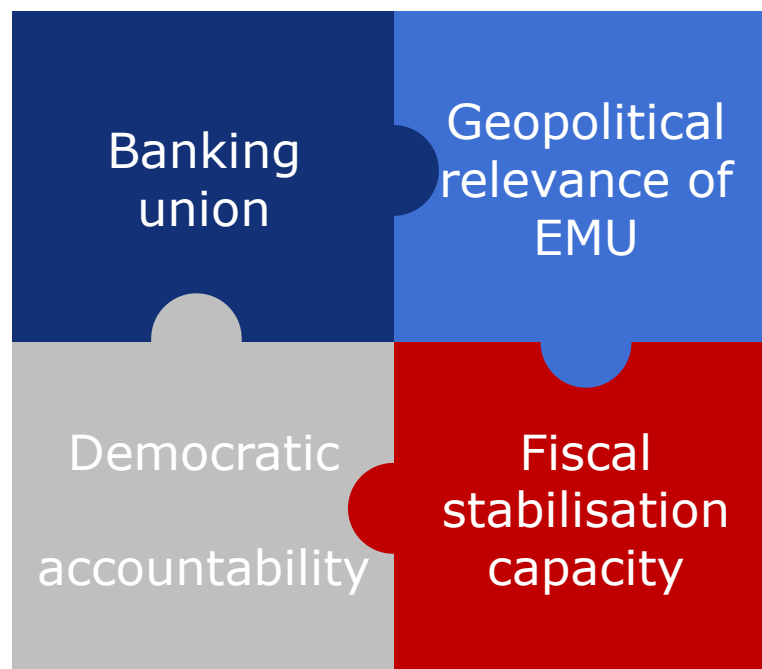
**M. Draghi** speech in Jackson Hole

“ *I do not blame Mr Ickes for being cautious and careful. But the risks of less speed must be weighed against those of more haste. He must get across the crevasses before it is dark.*

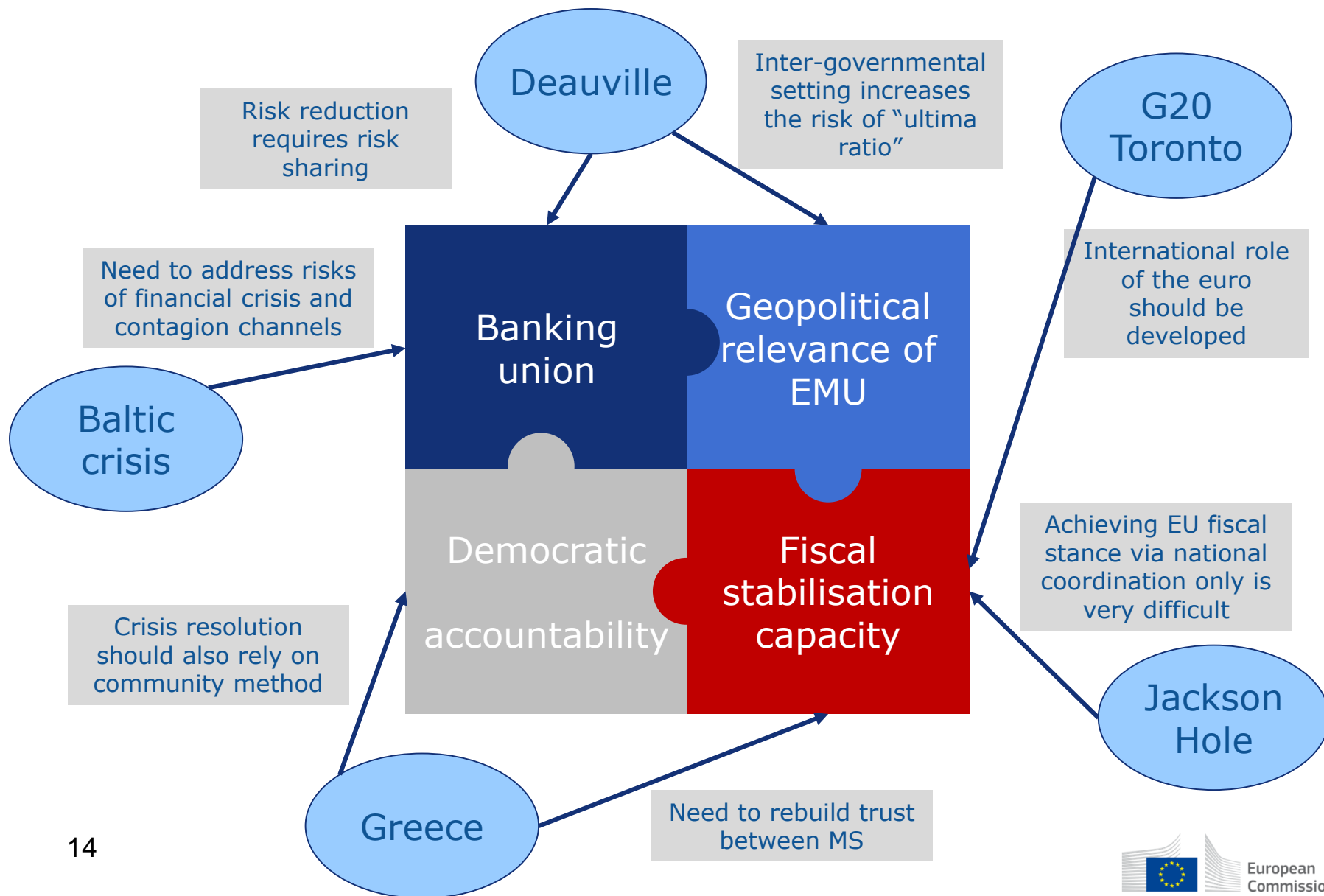
**1933**

**J.M. Keynes**, letter to F.D. Roosevelt

# Key lessons for future work on EMU

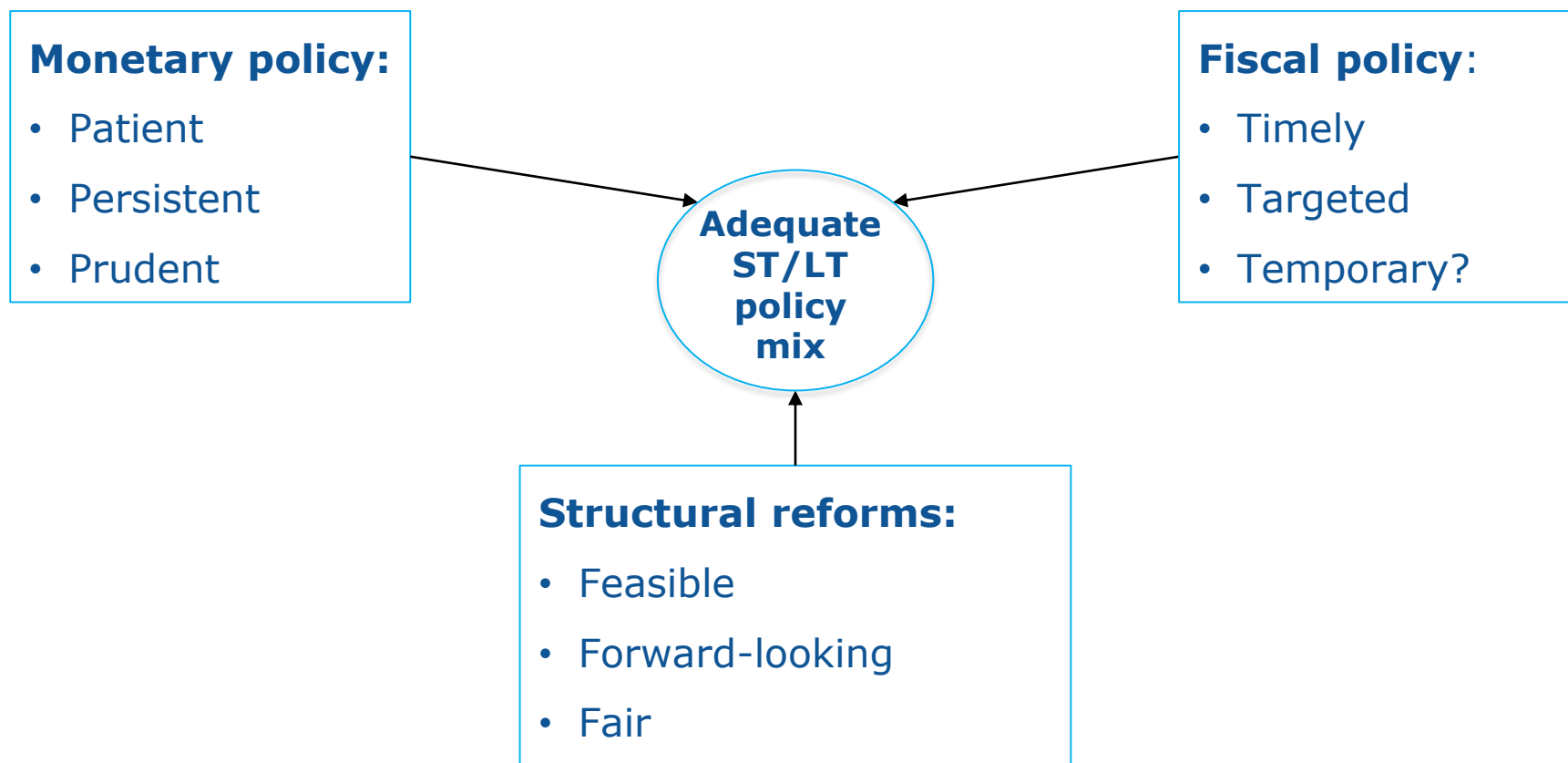


# Key lessons for future work on EMU



# Policy choices to address both ST and LT challenges

« *Right here, right now* »





European  
Commission

Marco Buti  
European Commission, DG ECFIN

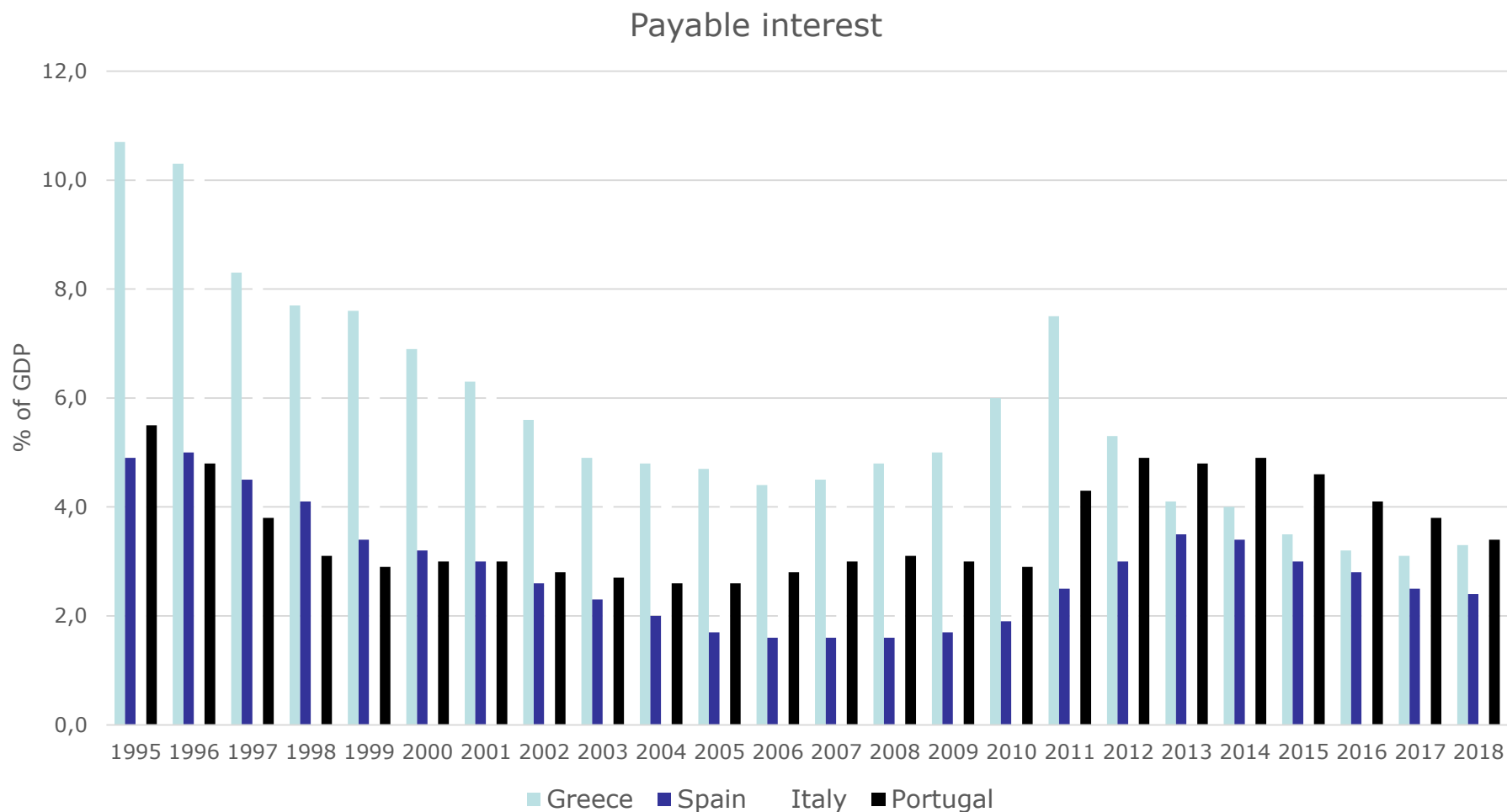




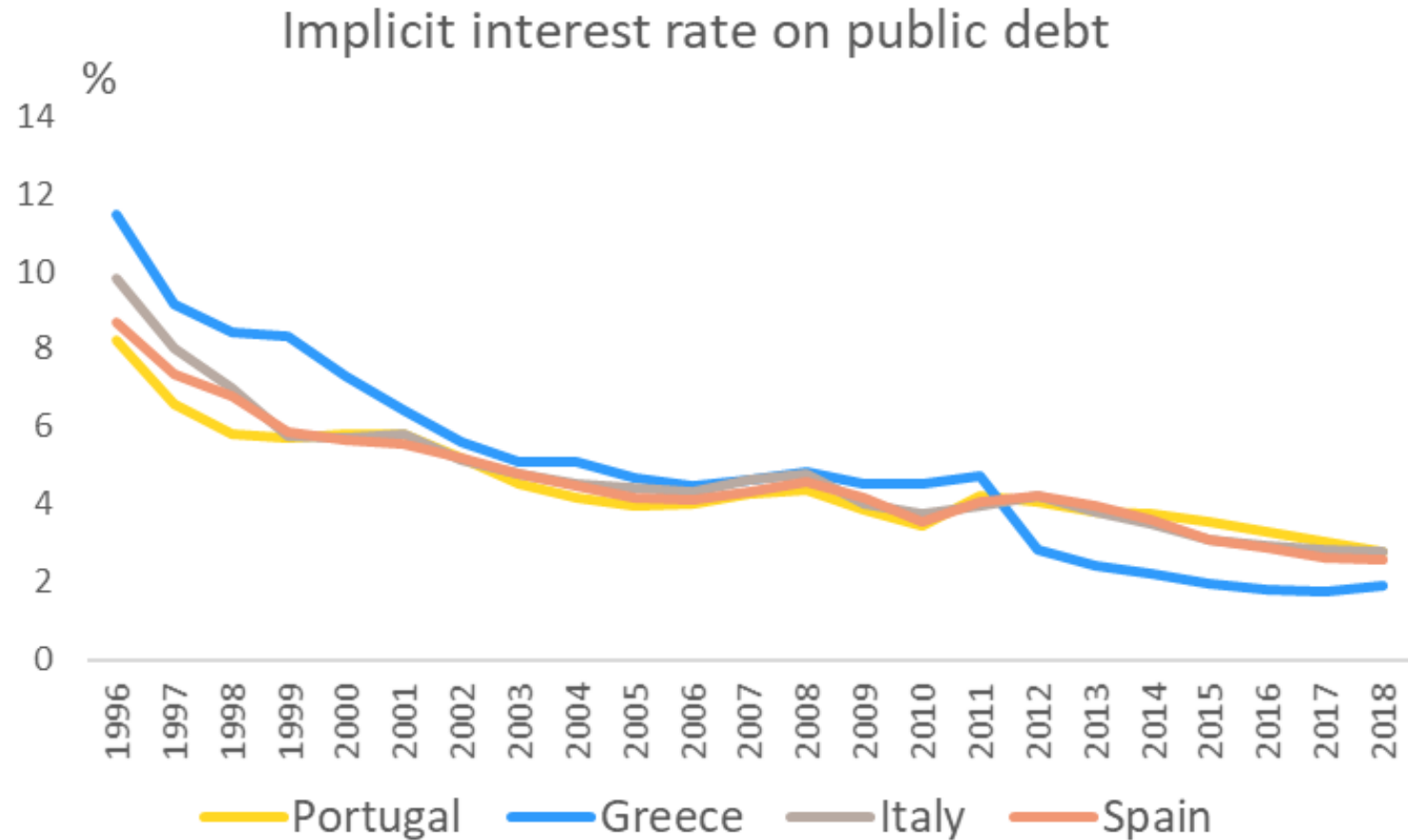
European  
Commission

# BACKGROUND

# Greece: Payable interests as a % of GDP



# Greece: Implicit rates on public debt



# Resetting the debate on EMU deepening?

- Any major economic **downturn will test the stability** of EMU architecture
- Completing EMU will help **advancing the wider economic strategic goals** such as global leadership & international role of the €
- New Commission as an opportunity to reset the debate:
  - **Completing the Banking & Capital Markets Unions**  
→ Key issue: How to combine market discipline with financial stability?
  - **Review of fiscal surveillance rules & Fiscal capacity**  
→ Key issue: reforming the SGP? Quid fiscal stabilisation?
  - **Improving effectiveness and democratic accountability of institutions**  
→ Key issue: keep seconding the shift to intergovernmentalism?

# Exact dates of 5 moments

- G20 Toronto: June 26–27, 2010
- Deauville: 18<sup>th</sup> Oct 2010
- Jackson Hole: 21-23 August 2014
- Baltics: multiple, see slide
- Greece: multiple, see slide