

Speech

Europe's Future from a US Perspective

Adam S. Posen (PIIE)

Delivered at the Vienna Institute for International Economic Studies, Vienna, Austria

March 30, 2017

Unedited Transcript

Adam Posen: Thank you all very much. I am very glad to be back in Vienna particularly at the Oesterreichische Nationalbank. I would like to thank sincerely President Svoboda, Research Director Stehrer, and Government Nowotny. The two institutions I've had the pleasure of working with intermittently through the years in Austria have been the Bank and the wiiw in American speak. They're both leaders. They both punch above their weight to use a phrase that Britain has squandered but still has some use. And I am very glad to be here this morning.

As Robert said, I'm supposed to give a US view. While I am happy if people want to talk about in the questions what's going on in the US -- not happy about what's going on in the US, happy to talk about it -- I have to make the usual disclaimer, not the [inaudible 0:01:12.4] Central Bank disclaimer, I am in the private life, but the disclaimer that there really isn't an American view on Europe because Americans don't pay attention to what's outside their borders.

And so the vast bulk of people in the US who have a view tend to be quite positive and they tend to be a very small minority of those out there. But given events both in the US and Europe, a number of people are forced to have a view now and they're often ill-informed. And part of the mission of the Peterson Institute, among many others, is to be honest and positive about the European Union project and economy.

I have a number of colleagues known to you, Simeon Djankov from Bulgaria, Olivier Blanchard, Jacob Kirkegaard, Jeromin Zettelmeyer, and others. And we try to bring a fact-based and therefore more positive perspective on Europe to the debate in the US and just in terms of the short-term economic outlook, I do want to echo what Governor Nowotny said.

A year ago, Blanchard and I published from the Institute something we called, *A Reality Check for the Global Economy*. We felt on the economic fundamentals people were being too pessimistic, and among the key points

we made was we felt that the economic fundamentals in Europe, in a cyclical sense, were very much coming together and that has been borne out.

And of course what is exciting right now, in terms of the European cyclical outlook, is the synchronization of expansion across almost essentially every economy in Europe, not just even in the Euro area. And that is something we have not had for some time, and none of us should take that for granted or ignore it.

But in the spirit not so much of just the Oesterreichische Nationalbank but of the wiiw and today's conference, I'd like to go a little longer term with the rest of my remarks and try to talk indeed about the future of Europe and lessons from the US, and I want to be clear, unlike certain people in the UK or certain people in the US, when I say lessons from the US, that means lessons from our mistakes and failures as well, not just be more like us. So I hope you'll take it in that spirit.

I am, however, going to make one wishful assumption. I'm going to assume the evil one is going to lose in the French elections. If the evil one does not lose, then we have a problem of severe proportions, which we can talk about later today. I am assuming just like the majority of the good voters of Austria rejecting hatred that the people of France in the end will reject hatred.

And I'm sorry. I'm not supposed to be political, but let us just be very clear. There is no room for such people in our societies. They should not be allowed to hold office. So my remarks are about the long-term, which assumes that the evil one loses. So let me go on from there.

I think as we talk about Europe at a crossroads, there are three large-scale assumptions that underpinned perhaps the entire 60 years since the Treaty of Rome, certainly much of the last 20 to 30 years even during the crisis, which are now no longer to be taken as assumptions.

The first was that you could achieve convergence through monetary union, especially here in Oesterreichische Nationalbank, and in this audience, I don't need to go into great detail on that; that is, of course of major intellectual debate as well as a real world debate. For what it's worth, I was an early advocate of the view that monetary policy and monetary union, while good on their own terms were unlikely to induce convergence.

I gave a lecture in Frankfurt in 1998 on that topic. I wrote things; again, it doesn't matter what I wrote but just to illustrate. At the time, it was very popular. There was a field of political economy being led by people like

Persson and Tabellini, for those of you who are into this academic literature. And it was very much whether it was influential on European development or whether it reflected the spirit of the times, European development is something intellectual historians can look at.

But it was essentially the idea that whether it was Central Bank independence or fiscal rules or monetary union that if you impose the right institutions you would change fundamentally the performance and the behavior of economies and populaces. And as I put it at the time in '98 and a subsequent article I published, I don't think that you can simply take olive trees to Sweden and expect them to grow or plan to catch herring off the coast of Puglia. Some things are fixed.

That's not a chronicle forecast of despair and nor is it an attack on the Euro. It's simply that there was a great deal of hope passed on the idea that monetary union would induce significant convergence, and that turned out not to be true and some of us expected that not to be true.

The second assumption that again I think was intellectually valid and certainly was nobly motivated, but we've learnt in the US or we should have learned from the US long before, also as a problem is the assumption that you could transcend regionalism or even localism. That you could try through the European ideals, which I fully support, to create a loyalty and identity that transcended the ethno-national local identities.

And of course, Vienna sitting here in Southeastern Europe and very aware, and at the wiiw tracking what goes on so well in the Balkans and through Eastern Europe, knows how strong some of these identities can be, whatever the economic irrationality, whatever the seeming lack of need. Again, I'm not counseling despair. I am merely saying that we have to, going forward, take this to account, and I think it's important here to draw from US history.

If you look at how the Americans voted for Mr. Trump, or now President Trump, and you look at how Americans have voted in the national presidential elections for the last, arguably 150 years, it is still largely defined by the extent of enslavement of African-Americans and what role the white population had in 1870. The largest predictor of voting patterns, along with education, which is a multi-colinear here, folks, which overlaps is essentially how many slaves were in a district if you go back to 150 years.

Now that doesn't explain everything certainly. But it goes with the previous point about non-convergence in the economic sense that Alabama and West Virginia are still Alabama and West Virginia. Massachusetts and California are still very distinct from those places

economically but also politically. And that is within the US where, of course, we did have a civil war and such divisions are subtle.

The third assumption, which hadn't really changed until very recently, but may indeed be the longest lasting change, I hope it is the only lasting change. I don't want this but it's unavoidable that Mr. Trump may be able to instill, which is that one can no longer -- just checking time -- one can no longer count on US alliance with absolute certainty.

I am hopeful perhaps confident that the US -- I won't use exactly the words President Svoboda used -- but the US attacks on Europe -- the US government's attacks on Europe -- excuse me, the Trump administration attacks on Europe -- and distancing from NATO are temporary, just as some of the crazy things the president has said about nuclear weapons in Korean and Japan are temporary. We hope these are temporary aberrations.

But it is impossible for responsible governments and peoples in Western Europe to sort of go on and say, particularly in Germany, to go on and say, well, we can just forget about it and assume that the cold war stays where it was, especially given as President Svoboda rightly notes the role of Mr. Putin.

So that all sounds pretty bad. No automatic convergence. Regionalism if not racism persists. US security guarantee is probably going to count if going forward, but Europe has to do a little more self-insurance than they used to. Okay. How do we go forward from there?

I think I and my clack of cosmopolitan elites that President Svoboda invoked, and I hope you consider yourself a member of the cosmopolitan elite. I know the history of the word cosmopolitan in Europe and I'm actually proud to be cosmopolitan even though it gets me a target sometimes.

When we speak about cosmopolitan elites, I think we got intellectually lazy because of these assumptions. We got caught up in the monetary union project for good reason. We got caught up in thinking that the European idea would over time create cohesion. And of course, we did not question the American security commitment on either side of the Atlantic.

But I think there were also two other factors. One was there's a side effect of having peace always better to have peace than anything else. There's a side effect of having peace that you don't have debt repudiations and you don't have overthrows of constitutions.

So when we look at the western world, the US Constitution gets amended occasionally, but really the last severe set of amendments, except for women's rights, were in the aftermath of the Civil War. You look at France and the Fifth Republic comes in, in the aftermath of the Algerian fiasco and the near coup. Obviously, the basic law in Germany, the post-war developments in Austria, in the Netherlands, elsewhere, all took place against the background of a previous war. Again, peace is good. This is not; it's a price certainly worth paying.

But what it means is you have institutions that don't necessarily adapt to the alignment of interests that are present today. They over privilege old interests, who are the incumbents from when the constitutions were written, which is particularly the case in the US if you look at the apportionment of who gets votes in the Congress and so on.

So what do you do if those are the realities of the world? I think it's important therefore to look at US history and realize that it has not been one linear progressive path, even though many of us in the cosmopolitan elite like to think that, that racism was continually being eroded, education was continually going up, urbanization and integration were continuing. And in Großen und Ganzen that was true but not completely.

A very great political scientist who's now known for other works, Samuel Huntington, wrote a book -- would have been in the '80s -- called *American Politics: The Promise of Disharmony*. And he wrote about what he called the IvI gap, that there was an ongoing conflict in the US between the ideals and the institutions and that you would have, not formal cycles, but you would have recurring bouts of disappointment and reaction.

And Sam -- actually it was his research assistant in college so long ago, which is partly why I'm a bad economist -- Sam like many people of his generation was reacting to the 68ers in Europe and the Vietnam protest in the US and civil rights protest in the US. And so, but of course that ultimately we could tell ourselves the tale, I think rightly, that that ultimately produced good outcomes in Europe and in the US. The question is, well, can we look beyond the recurrence of the cycle, the hopefully temporary or can we make temporary the period of reaction?

So I see people looking at their watches, so I hope I'm not being too boring here. Let me now turn to what is the positive agenda if we take this view.

So the first thing that has to be done is some fundamental philosophical view, which is, one needs to change the technocratic impetus. I said change, not remove. So, for instance, Dr. Stehrer mentioned the idea which I think is a very real question, "Who is legitimate?" If we're going

to do further integration [inaudible 0:16:28.0] further European efforts, who can legitimately put that forward? And what I mean about the technocratic impulse is it's time to forget about the word legitimate.

There is this hopeful belief, and I see Carl [inaudible 0:16:46] in the front row, that we need to fix things by being more responsive to democracy, more responsive to people's claims, more responsive to interest groups, more transparent, on and on and on. I am old enough to remember from when I first lived in Europe, now 25 years ago, the talk about subsidiarity at the time. I mean I was a professor, so the world has been through many of these cycles.

But the fact is democratic legitimacy remains something of an oxymoron. If we look at the recent referenda this is, I think, in a sense the most interesting thing about Brexit. It's otherwise just sort of tawdry and sad. But if you look at the recent referenda, for example, Brexit, was there any meaningful conscious vote that really was embodied in that question? Does it really matter that it was on that particular day at that particular moment 52% for and 48 against? How does one think about it when so little turnout from the youth were there even though the youth polled and increased the subsequently polled totally for staying in the European Union?

You look at the US where Mr. Trump arguably won the election for a variety of reasons. It's over-determined as we say in social science. But there's increasing reason to think that the particular announcements made by the FBI director on a particular set of dates ahead of the election had a very meaningful impact.

We just noted the passing of the great economist, Ken Arrow, and the one piece of his work that has made its way into the popular culture it deserves to have is the impossibility theorem, that if it turns out you're trying to do social choice and you have anything other than a straight binary choice for people of multidimensional choice, mathematically it's impossible to come up with a voting rule that legitimately represents the choice.

I'm obviously not standing up here and saying down with the people, up with Brussels. That would be unpopular even for me. What I am suggesting is the technocrats and leaders have to be more like frankly the Trumpers or the Brexiteers. If you've got power, run with it. Go back to the old-fashioned view of democracy. If you lose the next election because you didn't deliver, then you're out. But while you're in, take it for everything you've got. And not only take it for everything you've got, take it for everything you've got with a mindset to making sure you don't lose the next election.

Now again that has echoes of [inaudible 0:19:57]. That even has echoes of the early days of the Bolsheviks in Russia and that's not an accident. It's not an accident that Mr. Bannon, Trump's astonishingly influential advisor, basically calls himself a Leninist, that he wants to engage in democratic centralism. I'm not so sure about the democratic part. But this is where I think we have to go. The fact remains there is power in Brussels. The fact remains that in Austria, thank god, the people of Austria voted a majority against the fascist. The fact remains that we will get a, what's called a midterm election in the US and the Congress in 2018.

So if you do go with the fact that the people who have power and have liberal value should be activists and should not tie themselves into knots for legitimacy, but have the realities that people are not going to overnight follow them and are certainly not going to give up their identities and not going to have convergence, what should you do? So finally I come to the economic and political economy policies.

I have a top 10 list. This is "How do you build a European state without a nation? How do you build more of a European state without invoking subject nationalism?" And again, it has to be in the spirit of you are playing, not to institutions that will transform the way people think, you don't expect that, not the institutions that will cause convergence in the short term, because you can't expect that, but that do consolidate the interest that currently exists and advance the ideals you want. So my top 10 list.

First, giving the likely nasty things that the US government under Trump is going to be doing and including starting of this week with the expected enormous rollback of environmental and energy rules. Basically, the EU and China should give the US two years. And they can say this publicly or not, but they should basically be coordinating that you have two years to come to your senses, whether that's adult supervision being brought into to the White House and to the policies, or a sufficient rise-up from the population against the government that the Republicans lose the majority in the Congress in the midterm election. That's about two years from now.

And if you don't have that, then it is time for the EU and China to aggressively come together on trade and environmental issues and strike back against the US. And there are a number of specifics we can talk about in a sense the thing that I would think would make most sense would be putting up a set of carbon taxes and tariffs on countries that try to export to you who do not have their own comparable carbon taxes.

Secondly, part of state building, unfortunately, is about having an enemy and usually mounting a national defense. If we look at the 17th, 18th, 19th, and early 20th centuries, that's how states are built. So Europe has to

take the reality that the US security guarantee has been made a little less real, that the Russian government under Mr. Putin has become definitely more aggressive, and frankly spend on defense and try to build transnational pan-European defense institutions beyond what already exists.

Again, you can say what's the legitimacy? But the flipside of that is conscription has never been popular in any society. I'm not saying you have to go to conscription. But I'm just saying that you look at European history, you look at American history. It never is popular to do this, but countries and governments managed to do it. And so, again, I'm not calling for conscription. I'm not calling for a standing European army, but I am calling for a meaningful commitment to European defense, not because President Trump is saying stupid things to Chancellor Merkel about burden sharing, but because the reality is Europe needs it and you can use it to help build a European identity.

Third, the US, like the UK, is in the process of throwing away all the soft power, as Joe and I would put it, that it had accumulated over the last several decades. The US is about to start banning foreign students pretty much in the way that the UK stupidly did. That's one symbol. There will be many others.

This means Euro vision is no longer a joke. This means that there is a huge vacuum for Western European, Eastern European, Trans-European culture to fill because frankly even in Asia, the Chinese dream is not an attractive soft-power dream, and for linguistic reasons as well as political reasons, it is not attractive, accessible to normal people even in Asia, let alone the rest of the world.

So if Europe wants to, we used to make fun of French and other efforts to subsidize the film industry and all these things, but Hollywood is going to lose. Putting it simply, it's time for Europe to make Euro vision 3D and just take over.

Fourth, getting one notch more economic and one notch more detailed and serious. One major change that Europe is going to have to make, particularly Western Europe, rich Europe is going to have to make, is you're going to have to accept formalization of a two-tier labor market. This is, of course, very controversial, very difficult given where the post-war consensus was built.

But pick you up on some things, both Governor Nowotny and especially President Svoboda said, although of course they are not advocating what I'm advocating, the migration issue isn't going to go away. And I don't

mean it's not going to go away politically, I mean the people are going to keep coming.

There will be some variation with how bad the turmoil is in Middle East and North Africa. There will be some variation depending on the weather and the season. There might even be a little bit of variation depending on if you take me seriously on national security, you start helping the Greeks and the Italians police the Med, but the bottom line is the people will keep coming.

And the economic argument in an aging Europe, I don't need to recap for this audience, is profound. But as people in the Netherlands and Sweden and Austria and other places in Europe have found, again, the convergence issue at large also fits at the individual worker level. You don't need to demonize a poor person coming from Syria or wherever to recognize that they probably do not have the productivity levels and training to march right into an Austrian manufacturing plant and do it.

I think you just have to recognize that because this is a multi-decade process, perhaps a generational process, to get those people up to standard. And so you do have to take seriously the idea of having a two-tier work market of a sub-minimum wage or a different minimum wage for people in low-skilled jobs. It is not an ideal, but it may be the best option.

And again looking at lessons from the US realities and mistakes, we have the sad reality in the US that there is an enormous informal labor market, which is overwhelmingly Latin Americans, both legal and non-legal migrants, and that exists. And if Mr. Trump puts up the border wall or does the effective equivalent with aggressive policing, that market doesn't go away, simply those people become even more scared, less able to bargain, have less wage advantages. And the same is largely true in Europe.

So whatever people say about migration, and opinions about migration go up and down and I can't dismiss that with one hand, but you should not feel hesitant about forcing through things that are unpopular or on this way. Because ethically and economically, pushing hard to integrate migrants is the right thing to do.

Fifth, as a complement to creating the two-tier labor market, the biggest form of structural reform I think Europe has to undertake in economic terms is service market liberalization. That remains even where there is free movement of labor, as it's true in the US much more regulated, much more constrained.

The potential gains from service market liberalization in Central Europe, including Germany and Austria, are very large. And politically, again I would defer to President Svoboda and others in this room who have more of a political [inaudible 0:30:37] than I do. But politically, there's something to be said for making the lawyers and the bankers and the economics professors have to compete globally and accept migrants and accept cross-border competition if we're asking the poor people to do that.

Now again I don't want to suggest there's been none of that in Europe. There certainly has been some. But we look at the US and this becomes a very real issue. It's interesting, my colleague, Jason Furman, who's joined the Peterson Institute was chairman of the Council of Economic Advisers under Obama. And while he was chair of the CEA, he put out some research and reports on the problems of occupational licensing. These essentially were barriers to entry, that they were divided up among the US states in various ways, that these were hugely privileging of mostly white middle class, upper middle class incumbents, and interfered with free labor mobility across the US.

And people, Democrats, were a little surprised he did this and Libertarian Republicans like, for instance, the Cato Institute, were pleasantly surprised he spoke about this. But I think it's another example of where the right kind of structure reform can happen that is integrationist in a real way is popular and is doable.

Sixth, subheading under services liberalization, get the bankers. One of the sad things which my friend, and who all of us read, Martin Wolf, has I think, been right about writing in recent years is if the US, in particular, but also in Western Europe, there had been proper prosecution of financial sector malfeasance, and at least some more visible change and turnover of what happened in the banking sector. I don't mean show trials. There was plenty of reason to do it.

Some of the political grounds for fascism would have been undercut. It's not too late for Europe to do this in economic terms by breaking down some of the cross-border barriers to bank integration and bank takeover and recapitalization. Again, Europe is making real progress here. We have the single supervisory mechanism. We have various things underway.

My colleague, Nicolas Véron, who splits his time between Bruegel and Peterson has written about this, and there's definitely progress. But it is not unreasonable for the leadership of Europe and the leadership of the member countries of Europe to be a little more out there and graphic that this is partly about teaching the bankers a proper lesson and putting them in their proper place.

Seventh, I want to pick up on what -- I didn't know he was going to say it, although I'm not surprised -- I want to pick up on what President [inaudible 0:33:33.2] said about public investment, private investment as well, of course. It is shocking to see the under investment in Europe even in the economically successful parts of Europe over the last decade.

However, to be fair, one has to look around and see that there was a huge underperformance of investment or under provision, I should say, not underperformance -- under-provision of both private and public sector investment in the US, of constructive investment in the UK and Japan. It's clearly not uniquely a European problem. And that's a whole discussion for another day that I would love to engage with you.

But just to say as the years go by and all the rich countries are showing symptoms of the same thing, the kind of arguments that Professor Robert Gordon of Northwestern has made and others that there's some fundamental downshift in technological progress we may not understand, take credence. If there was more variation across countries and across regions in the amount of investment, and there was more pickup across countries and across regions in response to low interest rates and growth of investment, you would fear less that it's some fundamental technological force. Nonetheless, whatever that technological force is, there is still room to improve investment particularly on the public side.

And so we have all these various attempts with European Investment Bank and Juncker Plan Number 8B, and god knows what else, to try to stimulate investment in Europe. And again, I can't sanctimoniously say, well, just do it, because we look at the US, and in contrast to what decades of political economy would tell us, people both in Europe and in the US in elected office seemed to be reluctant to engage in public investment. And all our political science models or economic versions of political science models assume that politicians love this.

They can build a bridge. They can build a school. They can stand there and say, "Ha, that's mine. Give me your vote." And for whatever reason that's not working and it's not because we don't have liquidity, and it's not because we don't have low interest rates, and it's not because bridges aren't falling apart that we want to fix. So how do we do this?

I think one issue, which a number of people have been speaking out on, including the no longer Eurogroup chair, Jeroen Dijsselbloem, but also my friend, Pier Carlo Padoan, the finance minister of Italy, is there is provision in the European Treaties in Stability and Growth Pact to essentially tie public investment to structural reforms, that you can loosen temporarily the budget limits in the SGP if somebody is doing, say, a labor

market reform that in the short term will likely be costly, will cause disruption, and you can compensate by expanding the budget limit.

I believe this to be exactly the right way to go. I think it can be re-tweaked and done on a larger scale. But I just want to endorse this movement within Europe, and I know there are people with the commission working on this, and I think this is a very good avenue to go. Almost done.

Eight, I think the EU has to rethink the idea of the convergence funds. And there are a couple of reasons for this. The first is, as I mentioned already, convergence isn't happening. Now, again, that's an overstatement. As the wiiw or for that matter the EBRD has shown, there is a lot of convergence in Eastern Europe at least in parts. And we can all go to Spain especially, and to a lesser degree Portugal and Greece, and see the manifold benefits of European Union membership, Euro membership, and Regis schools, dance, everything, thanks to convergence funds. Nonetheless, the returns on this politically or economically have not been as close, anywhere near as large as I think they were hoped to be.

The second reason I think we need to rethink the convergent funds has to do with the form of moral hazard that is very problematic in both the US and in Europe, but which doesn't get talked about very much. Which is if you have a declining community, a poor community, a community that is deindustrializing, so in the UK it was Wales, just for example -- I'm not going to pick a non-UK example because I know I will annoy somebody in here whereas if I pick on the UK nobody cares -- so Wales. And the coal mines in Wales ceased to be terribly useful decades ago, and the technology for extracting coal improved decades ago, and so, there are no jobs in the coal mines anymore or very few. The same can be said of Kentucky and West Virginia and parts of Ohio in the US.

And clearly there is a problem, because when that shuts down, when a community is heavily dependent, to state the obvious, it's heavily dependent on a given industry, even a backwards dirty one; it drags down everything in the community. It drags down the tax base. It drags down the inflow of people. It encourages younger people to leave who have higher skills. It reduces real estate values. All true.

But, of course, the moral hazard is, if you put money into that community again, you are discouraging those people from having to move and having to adapt and having to change. And for all my being considered loony left in the US, which makes me center-right in Europe, if at some point you believe in the market economy, this is a real form of moral hazard. And this again has a very pernicious political effect, because then you have the coal miners or steelworkers or whoever, who sit there and basically have to become -- to the degree it's motivated by something other than racism --

have to become forces for reaction because that is their economic way out. They have to insist, "Oh if only you could bring back the coal jobs to Kentucky or to Wales or to Nordrhein-Westfalen or wherever.

And this is what I meant earlier about the technocrats have to not only try and do the right thing and ignore the short-term Democratic forces, until they get turned over in their regular term, but that you have to think about the next election. That you cannot, as much as your heart may bleed for Wales or Kentucky or for wherever, you are sowing the seeds of not only unsustainable bad economics but unsustainable bad politics if you keep bribing these people to stay where they are. It is a terrible moral hazard. The US had to confront this and did a very bad job of this when the big hurricane hit New Orleans, for example. New Orleans has no -- it's a lovely place, the food is wonderful -- has no business really existing. It is a huge swamp that, unbelievably aggressive, engineering works have kept from falling into the sea before.

So we have this huge hurricane, and a couple of million people were temporarily, at least temporarily displaced. And so of course what happened was all the poor African-Americans -- I shouldn't say all -- predominantly the poor African-Americans who are used to being displaced and do not have the political clout, they got up and moved. And so there are hundreds of thousands of poor African-Americans from New Orleans who have moved elsewhere in Louisiana to Houston, which is a booming metropolis in Texas a short distance away and other parts of the US.

And a certain number of politically entrenched African-Americans and the white people in New Orleans all came back and got federal funds. I'm not saying they're living on the [inaudible 0:42:25.3] and everything is wonderful. It's not. But the US had a choice at that point to stop providing classic moral hazard. You don't keep rebuilding in a floodplain. And we didn't do the right thing. And so you just entrench again this reactionary thing. It's a clear example. So, convergence funds need to be rethought. I'm actually going to cut the list back to those eight. I'm not sure about my ninth on second thought. Let me just end with the following:

Technocracy likes to believe that if we do the right thing, the benefits would become evident quickly and that we will therefore be vindicated and politically supported and technocracy, I mean pundits, like me, I mean, the people in Brussels, I mean many of the people in this room, wiiw included. But as Martin Luther King Jr. pointed out -- I'm going to mangle the quote -- if I write this up, I will get the quote right -- but, "The arc of justice goes very long and doesn't bend just one way."

You cannot count on the fact that doing the right thing will get you the political support you need or that even if it's doing something good will show sufficient results in the short term. And the fiction, the fantasy, the understandable intellectual game that was played to justify a lot of Europe in the, what I called the Italian School of Political Economy, they motivated all that, that if we build the institutions, there will be convergence, people will like it, all will get better -- was too optimistic, too facile, assumed too much commonality across regions, across people and too much, too little stickiness in how the economies work.

So the alternative as a future for the EU has to be not tailoring back the ideals, not opening up democracy more so that Europe can be forced to deviate from the values which it should have. It's got to be more realistic, sort of medium targets of institutions, that we shuffle the interest advanced economics, but don't presume that you're going to achieve fast convergence or quick buy in. And I've given eight examples of ways in which I think Europe can move forward and do that. Thank you very much for your time.

Moderator: Wonderful talk. Oh thank you very much for this very inspiring and clear talk of eight [inaudible 0:45:44.1]. Of course, we're all curious about the point 9 and 10 and even further [inaudible 0:45:49.0] down the list, I think. But in the ten, the eight points raised, now, I think is enough food for discussion. And so I'm happy to open the floor for discussions and comments. Yes, please.

Unknown Male: [inaudible 0:46:05.7]

Female Speaker: [Inaudible 0:46:13] is right and I absolutely agree, but on the other hand [inaudible 0:46:37.0] and a huge unrest. So [inaudible 0:46:46.4]

Adam Posen: Look, I think it's entirely legit. Thank you for your kind words. I think it's entirely legitimate obviously pushback in any of my things, but particularly I take your point. This is, there is a political logic why in addition to being against inequality, there have been the convergence funds and things not as good, but like them in other context.

The way I would pushback is its usual question of how you interpret economic history and how cynical realist you are. Economies have thrived generally when there has been, not necessarily labor mobility in the [inaudible 0:47:35.0] sense of, okay, I can leave this job and go to another job because that matters.

But literally that people move and we've seen this. I was talking with Mario, who will be presenting later on the way over here. We've seen in the Balkans, as well as the Baltics, and in Ireland and in Poland and in

Portugal -- we've seen mass migration in response to economic cycles, and it's not ideal and it's not great for some of the people left behind, particularly the elderly. And it worsens inequality in some ways and lessens inequality in other ways and the net effect over time we don't know.

But in reality that essentially becomes necessary, to my mind, and you say well people don't -- there may be reaction. There may be. But right now, we're already facing the kind of reaction that I would most fear. So it's hard for me to see it being that much worse, frankly. I mean I can imagine worse but --

And so, again, I can just rattle off the examples. The African-American community in the US finally gained economically, when there was a mass migration north from the plantations of the south to the industrial plants of the north. The Irish gained finally, when a number of them moved to the US and elsewhere and the UK and elsewhere and then moved back.

In the response to the 1930s depression in the US, there was the horrendous act of the dust bowl. And recent research has shown how much that was actually in part due -- for those of who are not familiar with this -- this was devastating to a huge swath of the US geographically and to agriculture. It was a lot done by bad policies and bad agricultural practices. It wasn't act of god but leave that aside.

The people who did best were the ones who picked up and moved to California. Read *The Grapes of Wrath* by Steinbeck. It doesn't sugarcoat it. It doesn't make it look good. It's awful. But that's the only thing that was going to save those people. And so if I was going back to number 9, I pulled back because I'm worried this is too idealistic, all right.

But essentially what I think Europe needs is a European-run program that moves unemployed young people from Greece and Portugal and Southern Italy and parts of Spain in very formalized ways north for work. And again that goes with the two-tier labor market and it goes with various other things. But that's how you do it. And then you look at [inaudible 0:50:26.1] -- I'm sorry to belabor it.

So I don't disagree with you. We're making choices between bad outcomes. If the world converged the way we hoped it did 25 years ago, hoped it would when we started 25 years ago with the single European market, we wouldn't have to make this choice. So I think it's a legitimate question. I've just decided while I'm thinking about it that the balance goes this other way. I may be wrong.

Male Speaker:

[Inaudible 0:51:11] response I would like to make modifications. Modifications [inaudible 0:51:19] lower income. If you just wait if the people are moving, they should move more, yes. But if the [inaudible 0:51:30.2] are moving all the problems of [inaudible 0:51:32] would accelerate because [inaudible 0:51:36.0] the actual plans was to spend money or not [inaudible 0:51:48.4], but there were not indicators of success of these certain programs, how many [inaudible 0:51:53.8] people are moving, we get [inaudible 0:52:19.1] where they move to. [inaudible 0:52:26.0] programs that will prevent migrants from coming to Austria because there are too many of them. And, of course, we would like to [inaudible 0:52:33] but we can't choose. So let us make programs which initiate a lot of initiatives and let us find the criteria [inaudible 0:52:43.9] that this program will [inaudible 0:52:46] as you said, this will result in jobs created that would be great.

And then something similar is a public investment program. I very much [inaudible 0:52:55] need more investment but [inaudible 0:52:58.8] investment and change. We don't need again more highways, more air, airports, and more tunnels. But we need investment in skills. We need investment into social innovations. And we need investment into decarbonization. [inaudible 0:53:18.0] decarbonization, we need a lot of investment [inaudible 0:53:20.5]. So I am a little bit afraid to suggest only public investment [inaudible 0:53:25.0] investment into the past infrastructure and we don't need it, 0:53:31.4] so many investments in tangible areas in space, in communication, and in social [inaudible 0:53:37]. Otherwise, I agree.

Adam Posen:

(I thought you were collecting [inaudible 0:53:43.1] sheets. Okay.) So, no sorry, so thank you, Carl. Quickly, again, this is all legitimate debate. I'm very glad we're having this. I think I would make three points. First is, and this goes also to the previous speaker's point.

I don't fully buy the idea that it's economic inequality that causes these people to vote that way. That's a whole other discussion and it's partly I'm colored by American experience where overt racism is, as I mentioned, a much bigger predictor than, thank god, it is in Europe. But I mean putting practically in a real world we can say fighting inequality is good unto itself, but I'm not sure the political benefits of directly fighting inequality are anywhere near as arduous as you seem to be saying. But I'm not going to try to mischaracterize you based on one question.

The second point is you've made an argument, and you know I'm familiar with your work. And so I know you've made it elsewhere, that the problem with public investment in part is its investment in the wrong things without the right indicators, as you said.

I'm more on the fence on that. I'm willing to buy the argument, that for a variety of reasons, which you know well, that public investment is biased towards backward-looking, big-ticket, tangible objects and not necessarily a reason that's useful. Nonetheless, I really don't think the problem is the quality of public investment, that if the quality of public investment had been better, everybody would be happier, and we would all be -- I know you're not saying that but to take it [inaudible 0:55:24.9].

I think it's much more that, and the reason I picked on the convergence funds, structural funds, is because those tend to be geographically targeted. And I think part of the problem is reinforcing these geographic divisions and reinforcing immobility of people. And so in a world of not great choices, I would rather -- it might even be some of the same investments you and I would agree on -- but I would rather have the criteria and the allocation be defined in terms of either individual benefits or utility of the projects as public goods and not as this region is X percent below the EU average, and therefore, it gets more money. Let me stop there.

Moderator: Michael. (Let's combine [inaudible 0:56:19.6])

Adam Posen: Of course.

Michael: [inaudible 0:56:21.7] thoughtful and interesting especially because that's something [inaudible 0:56:29.1] sufficiently move to look at the reason [inaudible 0:56:34.2] economics. And I think there's a huge deficit. And I think of the [inaudible 0:56:40.6] in the US and in Europe we are [inaudible 0:56:41.7] because we don't think about enough of it, but we also, it's very 0:56:49.8]. And I think in many ways you've expressed conjectures [inaudible 0:56:55].

Adam Posen: Absolutely.

Michael: We don't have very hard facts or [inaudible 0:56:58.5] on that. But, overall, I think your talk was rather sobering. It really reflects [inaudible 0:57:07.0]. And I think some of your points all served initial assumptions [inaudible 0:57:15.7] theories, namely and the [inaudible 0:57:19.6] convergence can be [inaudible 0:57:27.7] of that. But of course [inaudible 0:57:32.0] your points, the two-tier labor markets, rather dismissive view of integration of migrants or of [inaudible 0:57:40.7] society. Which itself raises the [inaudible 0:57:47.0] conflict, and, of course, also again, the skeptic view of convergence being a topic [inaudible 0:58:03] which will accompany us in the discussion today, rather somber image of what we can expect.

Now, my question for you is [inaudible 0:58:13] that you survive, almost the entrenchment of such [inaudible 0:58:20.0] within countries, the regionalism, the localism [inaudible 0:58:26.4], giving up the realistic idea of [inaudible 0:58:32.9] non-convergence generates. I think you did bring out fine conclusions on that [inaudible 0:58:43.0]. How will the [inaudible 0:58:41.5] survive [inaudible 0:58:42.7].

Moderator: We'll have to combine a few questions [inaudible 0:58:46.9]. One, Mr. [inaudible 0:58:50.9] at the front here. I think, unfortunately, we are running out of time already. So please short questions. There is a possibility in the afternoon panel that many of these questions will be brought up again, probably, since there will be room for discussions in the afternoon and of course over coffee break. So take these three questions and [inaudible 0:59:12.9].

Unknown Male: -- question after this [inaudible 0:59:14.7].

Male Speaker: Yeah very briefly and quick, actually, Vienna Institute [inaudible 0:59:19.2] and also to the, I think [inaudible 0:59:23.0] provocative for [inaudible 0:59:26.9]. No. I would like to point to some inconsistencies in your eight points, or nine points. And that is, I think, it's very positive that you kind of talked in favor of soft power of Europe, but it seems to me it is very economist approach of liberalization and moving people whole scale from depressing areas, including [inaudible 1:00:02.8] contradiction to the soft power, [inaudible 1:00:06.7] cultural [inaudible 1:00:09.2] adversity.

Adam Posen: Adversity, yep.

Male Speaker 1: And so, I wonder, isn't all [inaudible 1:00:15.9] type of cultural features that Europe has in some respect connected with [inaudible 1:00:22.2]. The question is then, how do you weigh that. You don't really want to [inaudible 1:00:26.5] because then you don't have soft power anymore. It's just a very economic type of driven society, which really creates a lot of inequality, a lot of disruption all the time and [inaudible 1:00:39] just a last point, that [inaudible 1:00:47.0] seem to be in a very one-directional path of economic and social direction, and [inaudible 1:00:53.6] for instance to really look at what [inaudible 1:00:57.1] to the monetary and economic crisis. It keeps carrying on the same way and it doesn't seem to be able to get out of this [inaudible 1:01:05.0] the same way, it doesn't try to learn from its mistakes.

Male Speaker 2: Thank you. I thought your speech was wonderful and really, very inspiring. You made the example from, brought the example from Wales. I ended up by chance, but this morning there was an interview on Austrian radio, people from Wales and some said "We don't want the money. We want jobs." And you saw also in the referendum in the UK that there are

many areas where you have a lot of money spent by EU, people rejected voted, [inaudible 1:01:38.8] Brexit.

Adam Posen: Right.

Male Speaker 2: So something has to be re-thought. As you said maybe different regions we have to have different answers.

My two small questions are you spoke about the liberalization about the services. Now you've mentioned lawyers and financial services, but there were also lower wage services.

Adam Posen: Yep.

Male Speaker 2: So it's different where you can provoke liberalization or not, maybe. That's the question.

And then on the two-tier labor market, you spoke about migrants that we have, of course, in Europe especially, as in Austria, as mentioned [inaudible 1:02:10.4] labor coming from Bulgaria and Romania. So is it the same two-tier labor market? Is it a three-tier labor market? Who do you put in the second or in the lower tier? Maybe you can a bit explain how you would handle that.

Moderator: [inaudible 1:02:29.3] Last question.

Male Speaker 3: Yes. Very short. In your second point, you say Europe should do more for its [inaudible 1:02:38.4]. And the third point you say, you should not [inaudible 1:02:41.1] combine perhaps your second and third -- so you have a new target -- to have combined hard power and soft power? Look at the US, it was really [inaudible 1:02:54.1].

Adam Posen: Right. Absolutely right.

Male Speaker 3: [inaudible 1:02:54.4]

Adam Posen: No, thank you. Thank you all very much. So I'll try to be brief. These are wonderful comments and so I'm very grateful.

Just let me respond to the gentleman's last comment, because I just completely agree. The soft power and hard power should be complements. They're not perfect substitutes, and they will always go together as the US has blown it in various ways, blown it [inaudible 1:03:23.8]. But the building of the Transatlantic Alliance was a perfect example of morally and usefully combining soft and hard power. And I believe the two can go together. And so I just completely agree with that.

I think there was -- let me get rid of the Kissinger thing for a second. When I was 13, I would have and it's very generous of you to compare. I don't have that ambition, thank god --

Unknown Male: [Inaudible 1:03:53.3] Well when you think about Chile and others --

Adam Posen: Right. Exactly. That's what I was about to say. When I was 13, I thought that was good. I've since realized war criminals are not always a good thing.

But just one thing that just sort of runs through a bit, all the questions, before I get more specific is how much am I sort of becoming excessively neo-liberal and by doing that in a sense contradicting either the European ideals or some of the results we want. And I think that's a legitimate concern in general terms as well as specifically to me.

My point of view is that, and this is partly where it is a US point of view, that if one maintains democracy, broadly speaking a welfare state, universal healthcare, heavily subsidized tertiary education and universities, some free movement of people across Europe, and a host of other things European code of justice. That matters a lot.

And so I'm not talking about going to the Keynesian London in the 19th century or even, god forbid, Trump's America. I'm talking about some very specific adjustments -- not that specific -- but some principles about maybe we should do less about regions and more about individuals. Maybe we should be, instead of doing frankly neoliberal reforms of labor markets that have worked so poorly in Greece and Portugal, we should be thinking about more aggressive forms that create jobs. So I don't think there's this big a gap between some of the things you're raising and at least my intent; I agree that there is some tension.

Turning to Michael [inaudible 1:05:40.5] and this goes also, of course, with Carl [inaudible 1:05:48.3] point. How [inaudible 1:05:50.2] am I getting? Will the EU survive retrenchment of its goals if the goals essentially, say, accept that there's going to be these kinds of divisions?

What I was trying to say is that one has to make policy with the fact that these divisions are persistent, as to make policy with, keeping in mind of the fact that these divisions are persistent and in no way denying they're pernicious. But that some of the European initiatives and some of the problems today are because of a failure to reckon with that reality.

And again so, am I being under ambitious? I tend to believe, that's why I tried to call them sort of medium goals. These are not tiny little ticky-

tacky goals. But they're simply not the goal that there will be one Europe with far less inequality and a European unified ideal in the next 20 years, that you have to try to tailor what you're doing to do that, to recognize that. And that's all I was trying to say.

And is it enough for Euro to survive? You know, if we're going to talk about that all day, we're going to talk about that all year. Essentially assuming the evil one does not win in France, and so following the Netherlands and the Austrian election, we do the center holds. My main message is the center then has to be aggressive and not worry about compromising with the 40% or 30% or whatever piece of voters voted for the fascist. Just move forward. And you have to move forward in ways that are deliverable and are not fantasies. And that's the spirit in which I mean this.

And finally turning to President Svoboda, it's funny about the Wales thing. As some of you know, I spent time at the Bank of England, as policymaker there. That's part of the reason why I have Wales in the head. When I'm in the US, I talk about West Virginia.

It is interesting. First, it's just stipulating you're absolutely right that service isn't just about lawyers and doctors. It's about house painters and bankers and construction workers and plumbers and folks on one set. We can call it nurses and teachers.

But I think it is important symbolically. Those people are under a lot of wage pressure, anyway, in most countries. And again, this is one of those things where how do you define neoliberal? I don't like the idea. I'm going to pick on Germany, rather than Austria. I don't like the idea that similar to the US and even more so, you need a qualification to be a bread person, bread sales person for the excessive degree in Germany. And the reason I remember this is I was living in Germany in '92 and '93 when unification occurs, and these things were genuinely barriers to people in Eastern Germany to get ahead.

And so I don't think it's, as the Green Party in Germany argued, I don't think it's cruel or unfair to suggest that in a market economy you need some pressure. You can't be -- I can be pretty liberal. Actually, I'm pretty left wing in the US context and not want to be that thing.

But the very important point, which you raised, which is identical to what we're facing in the US, is the people who say I don't want different programs, I want a job. And this is a nightmare. It's understandable but it's a nightmare because what happens is actually these people, whether it's Wales or West Virginia or wherever, are saying I want this job in this

place. And that cannot be what we promise people. And I know you know this. It's just, I mean, literally we didn't [inaudible 1:10:09.8] Washington.

We were talking about the border tax proposal. And a business representative who's a long-time Washington insider stood up after my remarks and said, "Adam, you know, you're full of -- this is -- what you're talking about isn't going to work because senators know that this is what they want. They want jobs, not this."

But in the end, you cannot say to people -- you just can't say to people, "We're going to guarantee you this job in this place" because what happens is eventually you'll end up saying to just small groups of specific people, usually white males, "Okay, we'll guarantee your job in this specific place by taxing everybody else. And further adjustments are going to have to be made by women and young people and people of color and migrants because you're not moving, and so the rest of the economy has to move more."

And in the end what I'm trying to argue, again, I know you know this, but what I'm trying to argue is it's not even smart politically, because what you end up doing is reinforcing the forces of reaction. And so you have to just have to take this on and tell, and force people that we will guarantee you an income. We will guarantee you healthcare. We will guarantee you, god willing, retraining. We will guarantee you many things for being a human and being a citizen, but we will not guarantee you a job of your choice in a specific place. And that has to be where the line is drawn because otherwise it is not a market economy and we are all the poorer for it in a very fundamental way. Thank you.