

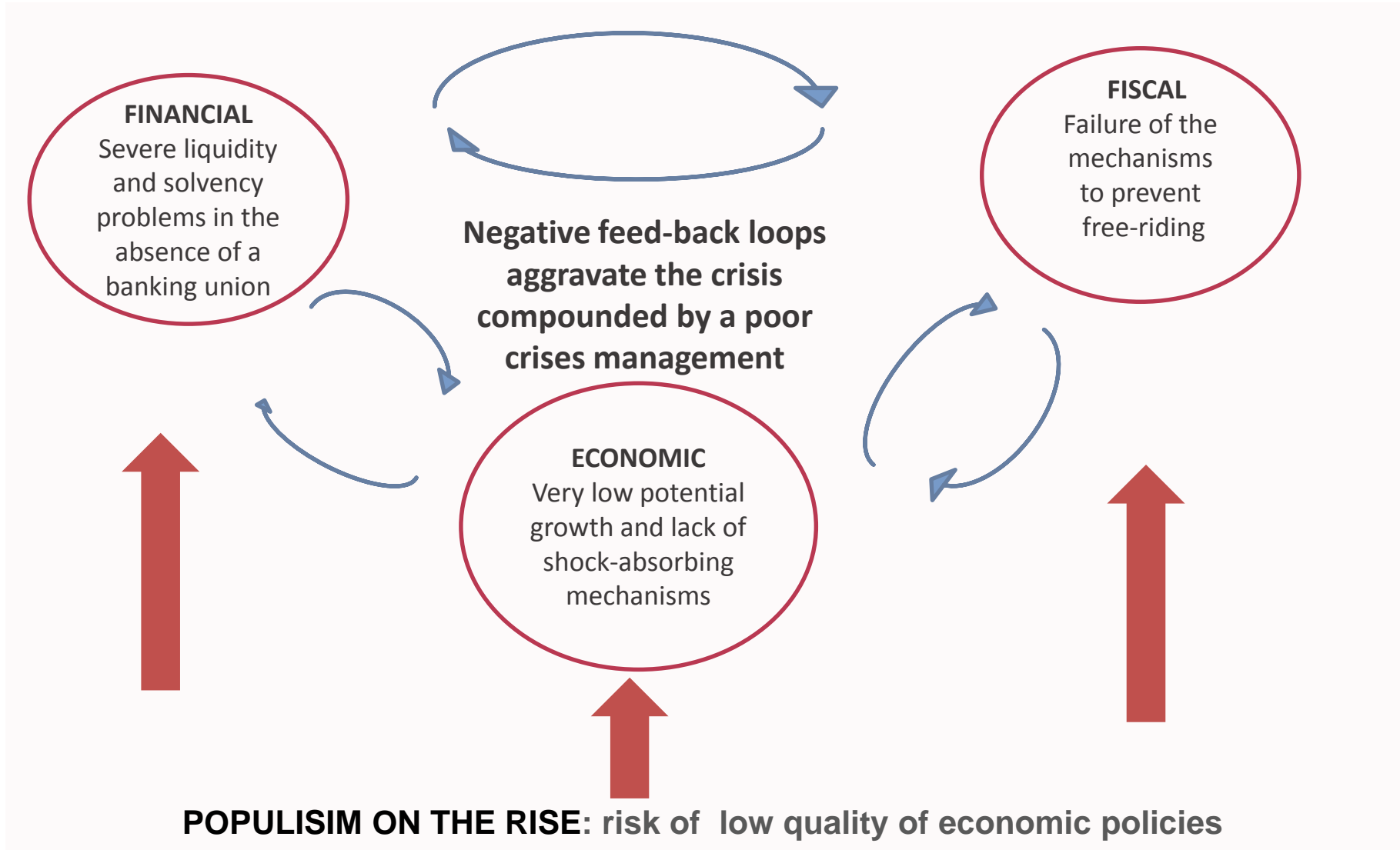


Independent Authority
for Fiscal Responsibility

Have sufficient measures been taken to forestall a new crisis?

**International Conference of Councils on Economic Policy
The Hague, 22 June 2018
José Luis Escrivá**

Stylized facts before the crisis in the EMU



Have reforms made a difference? Ready to forestall a new crisis?

❖ Still problems at national....

❖ ...and euro area level

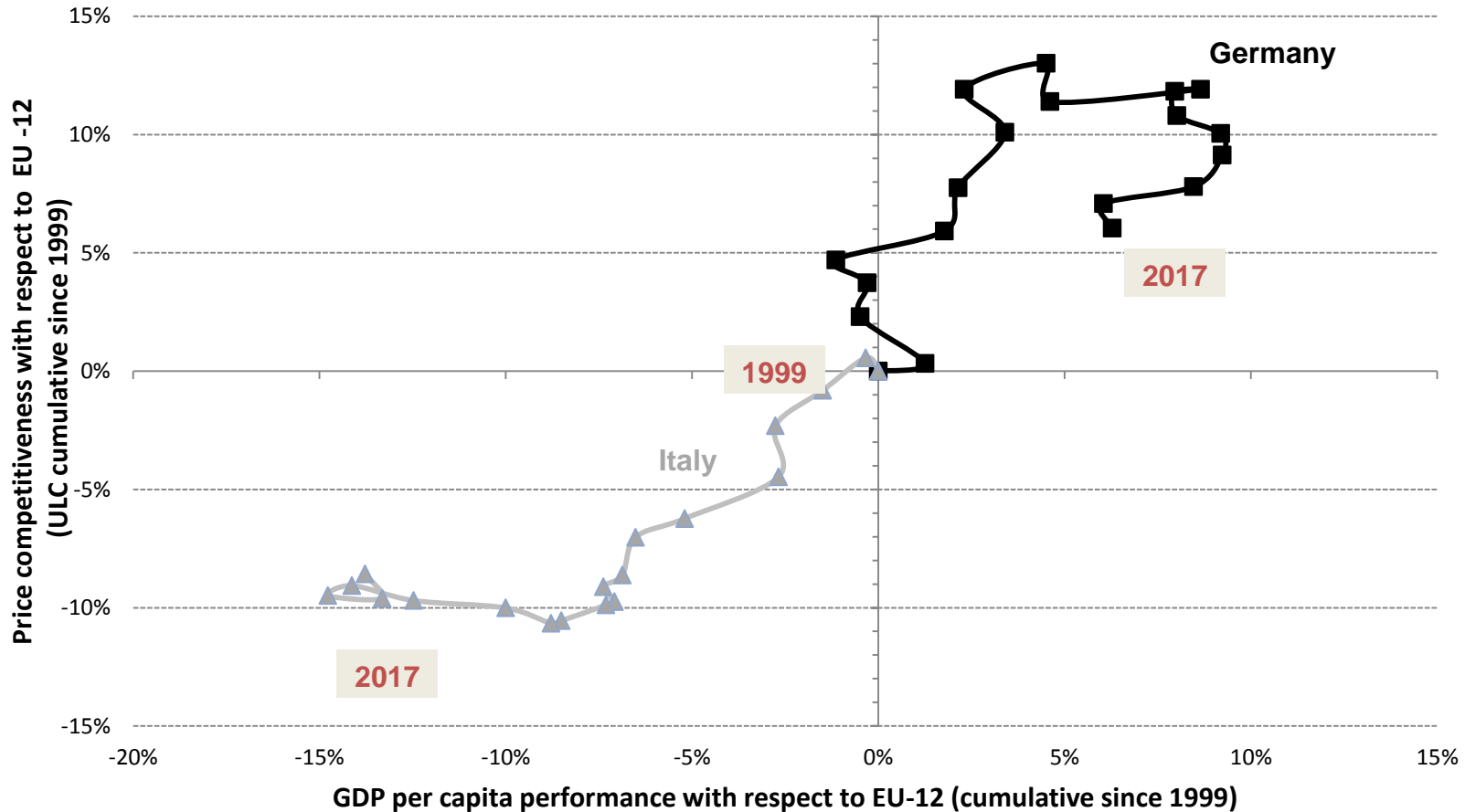
1. INCONSISTENT DOMESTIC POLICIES WITH THE EMU

- **Lack of discipline following the loss of exchange rate and monetary policies**
- **Insufficient real convergence**
- **Competitiveness losses and free rider behaviors**

2. COORDINATION FAILURE

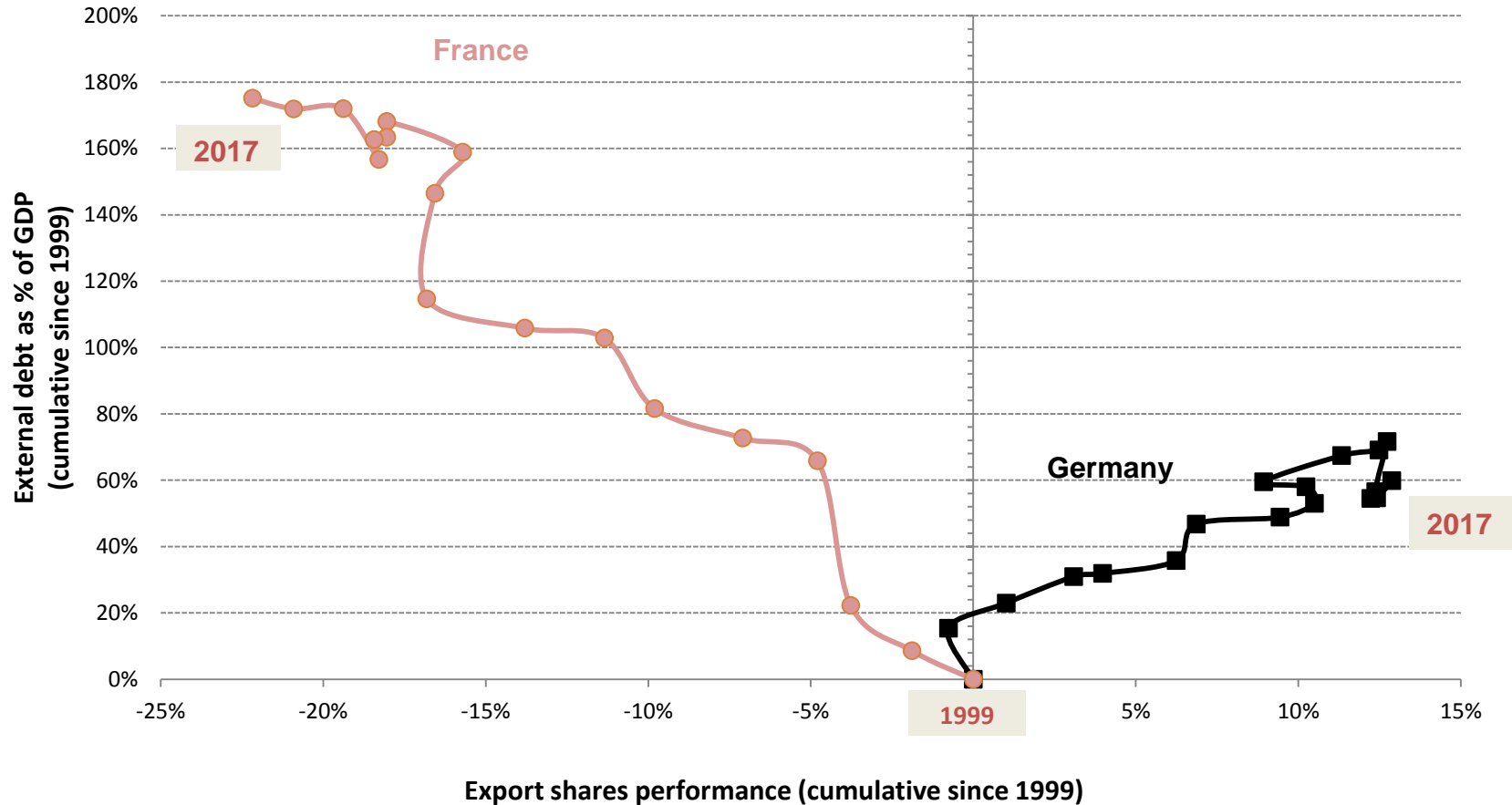
- **Design and governance problems**
- **Non-cooperative behavior and renationalization of decisions**
- **Lack of common tools to manage the crisis**

1. Inconsistent national policies: diverging patterns in competitiveness and welfare. Are they sustainable?



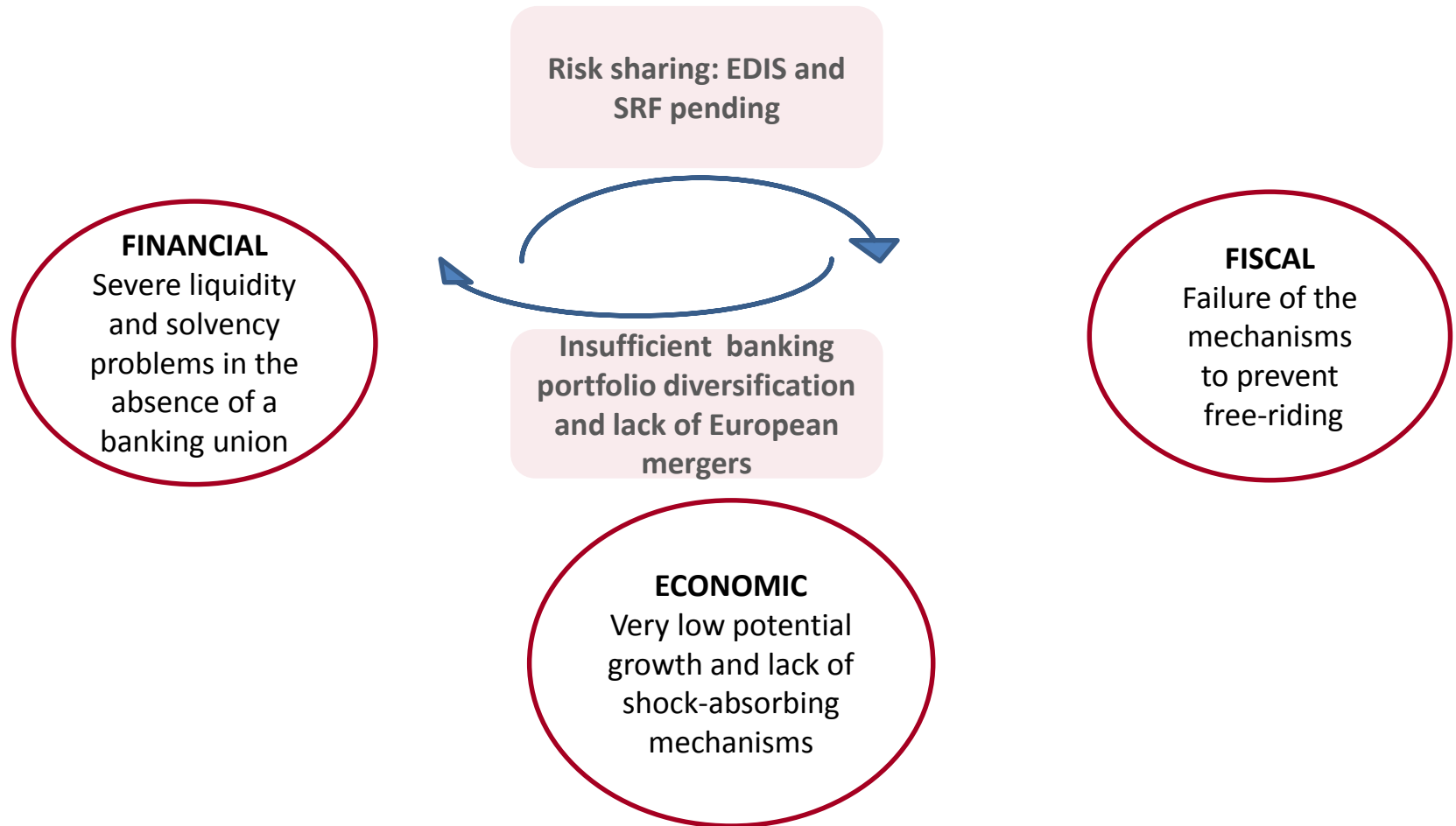
Source: Eurostat

1. Inconsistent national policies: diverging debt performance. Underlying vulnerability for the EMU



Source: Eurostat and IMF

2. Coordination failure: limited progress in breaking these loops



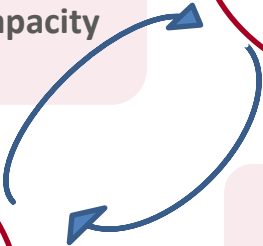
FINANCIAL
Severe liquidity and solvency problems in the absence of a banking union

No progress on a central fiscal capacity

FISCAL
Failure of the mechanisms to prevent free-riding

ECONOMIC
Very low potential growth and lack of shock-absorbing mechanisms

Procyclical fiscal rules



FINANCIAL

Severe liquidity and solvency problems in the absence of a banking union

Slow progress on
Capital Markets Union

FISCAL

Failure of the mechanisms to prevent free-riding

Single Supervisory Mechanisms >> banking resilience strengthened

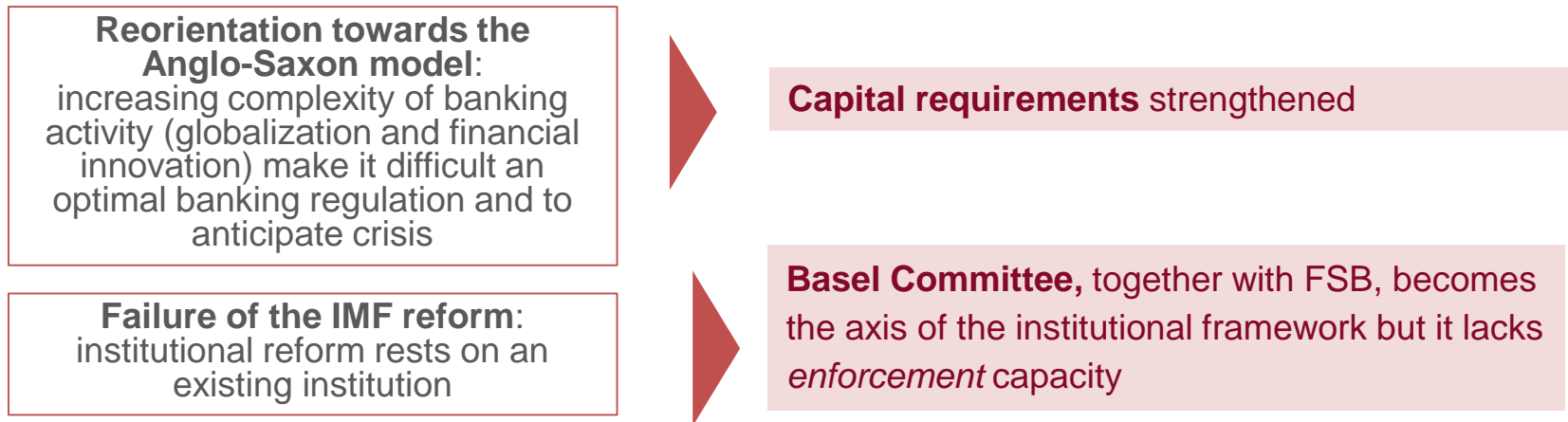
REFORM OF THE INTERNATIONAL FINANCIAL SYSTEM WELL BEHIND INITIAL PLANS

ECONOMIC

Very low potential growth and lack of shock-absorbing mechanisms

Very modest progress in the initially ambitious G-20 reform agenda

- **The London and Pittsburgh Summits (2009) envisaged a very comprehensive reform:** IMF mandate, accounting standards, financial taxation, banking resolutions, strengthened supervision, OTC markets or rating agencies
- **But modest progress has obliged to redesign initial plans:**



"We deeply regret that the IMF quota and governance reforms agreed to in 2010 have not yet become effective"

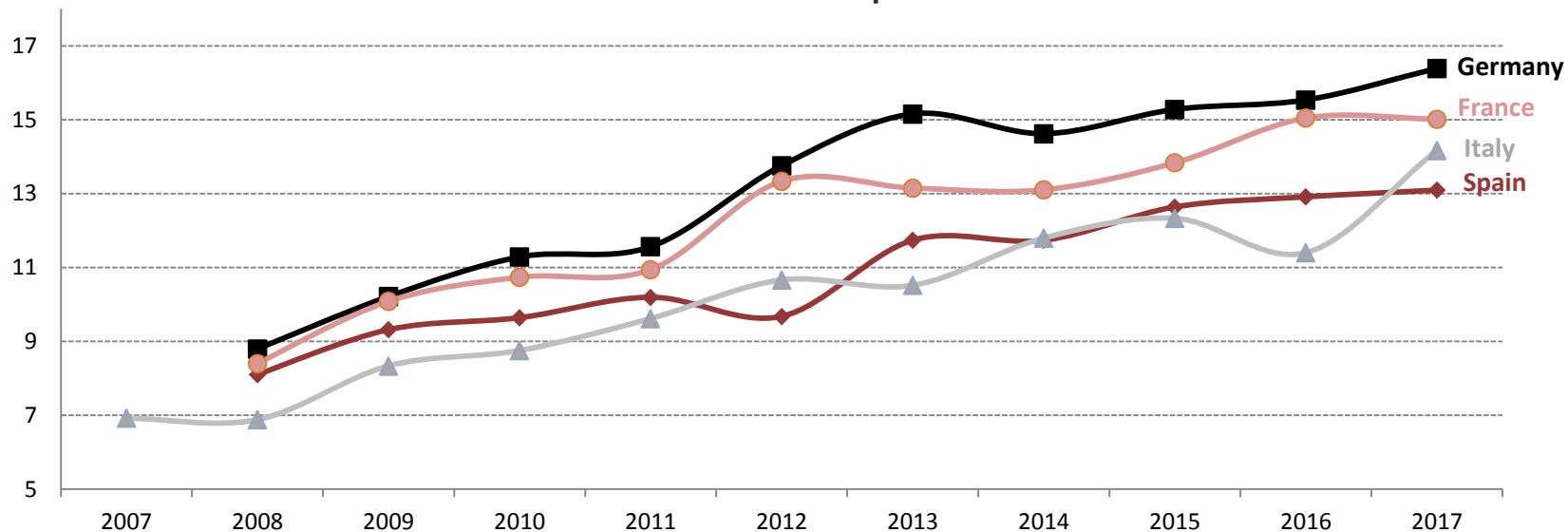
Source: G20 Statement (Feb 2014), Sidney

"There is no substitute to reforming the global multilateral institutions and making them work more broadly for the membership" Source: R. Rajan (2015), FT interview

Main axis of the current reforms

1 Capital increases and leverage ratio reductions

EMU banks: Tier 1 capital ratio



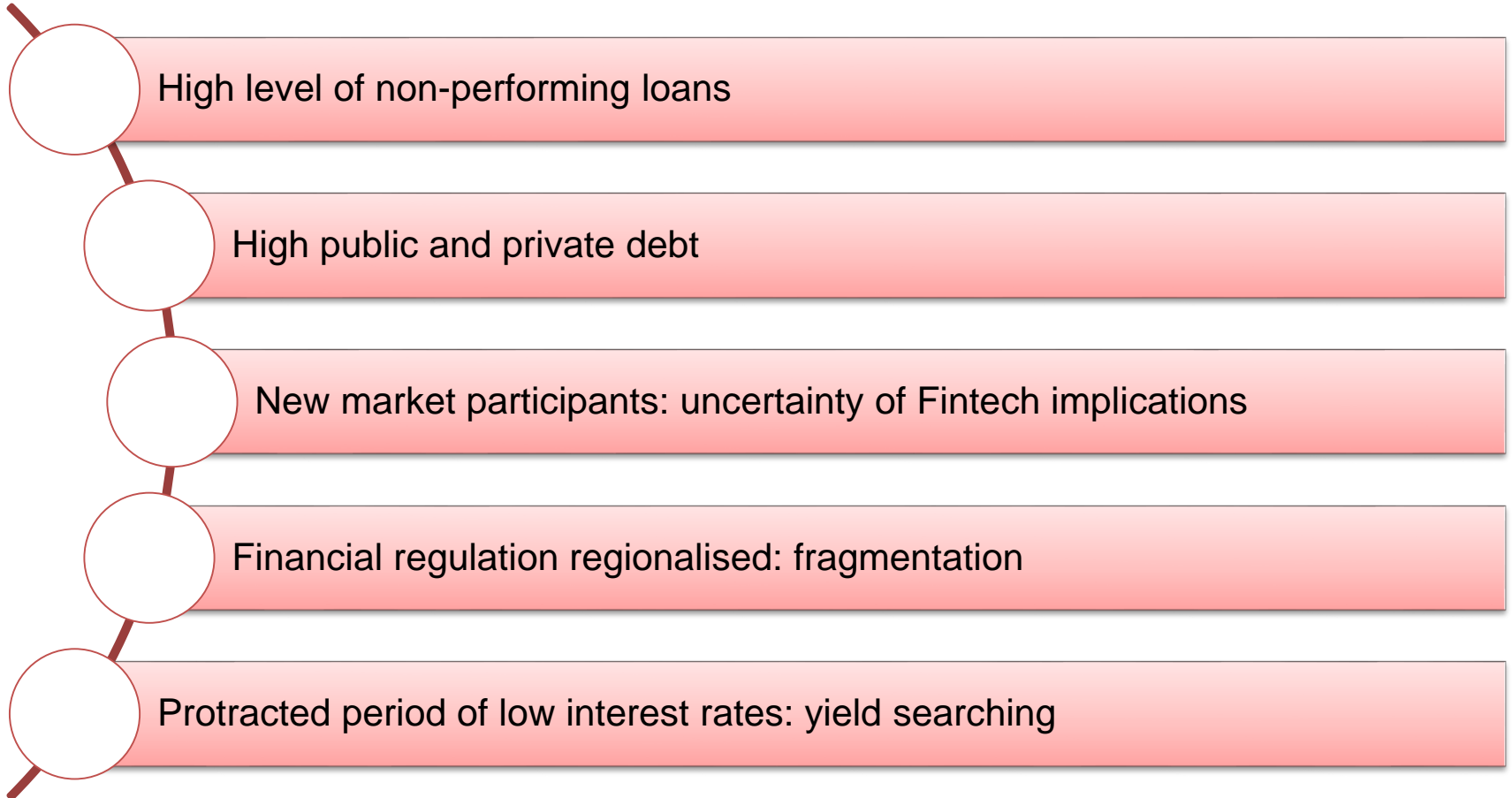
Source: ECB

2 Stress- tests aimed at building buffers: a more complex system

- Three supervisors declare having more than 50 full-time people devoted to stress-testing
- Stress-testing in the EU requires at least 250 full-time people
- Multiple capital requirements in the USA: Federal Reserve proposals to reduce them up to 14

3 Corporate governance strengthened

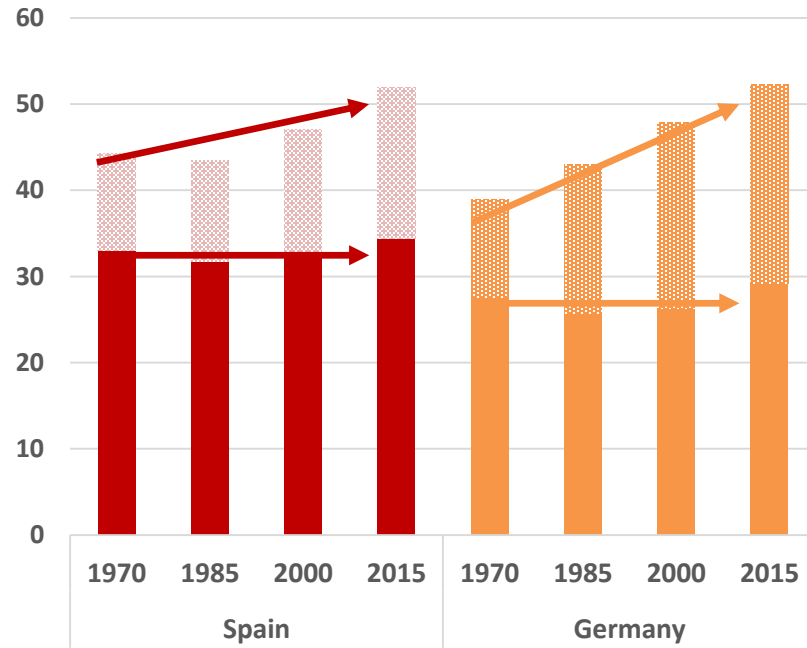
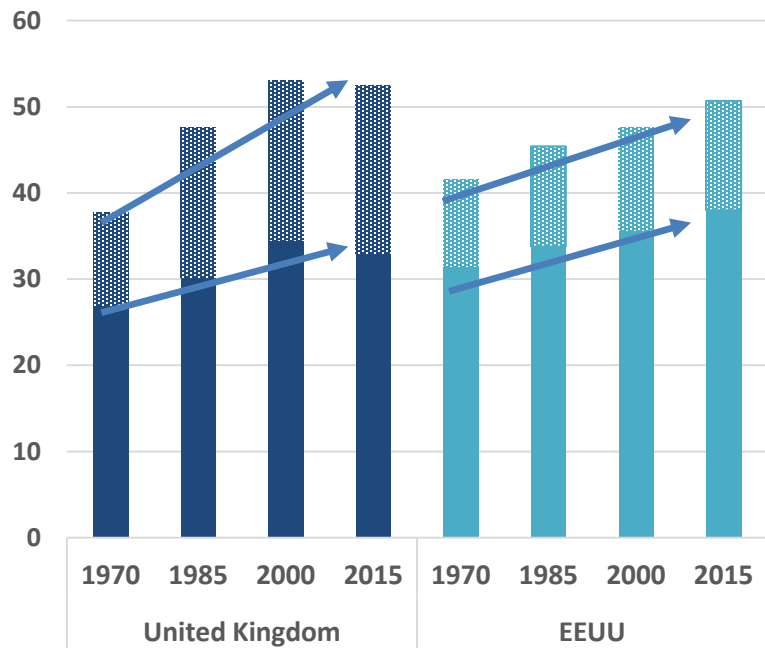
Despite improvements in financial stability at least 5 sources of risks remain



Does inequality matter? Empirical evidence

Different patterns in Anglo Saxon and Continental Europe

Gini index
Market and Disposable Income



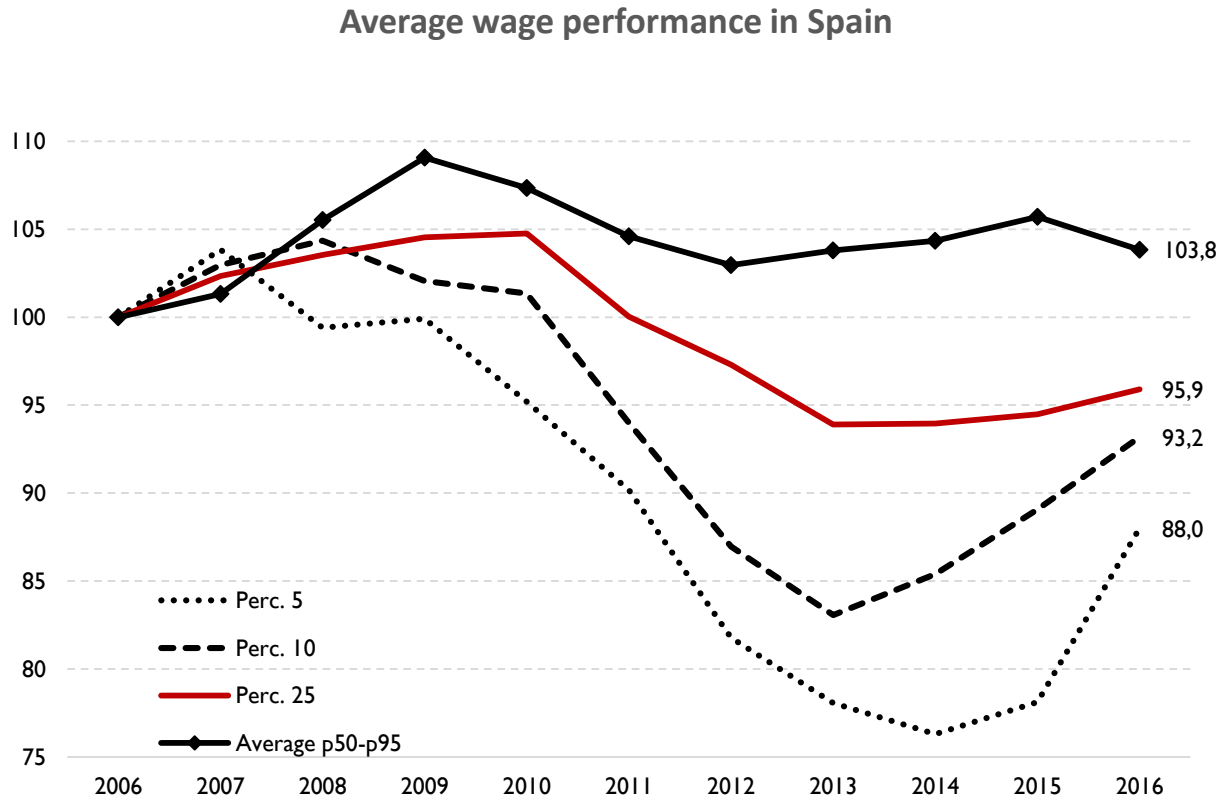
Source: SWIIP 2017

❖ Increasing inequality even after redistributive policies

❖ Redistributive policies have limited the impact of the increasing inequality in terms of market income

A closer look at inequality performance in Spain during the crisis

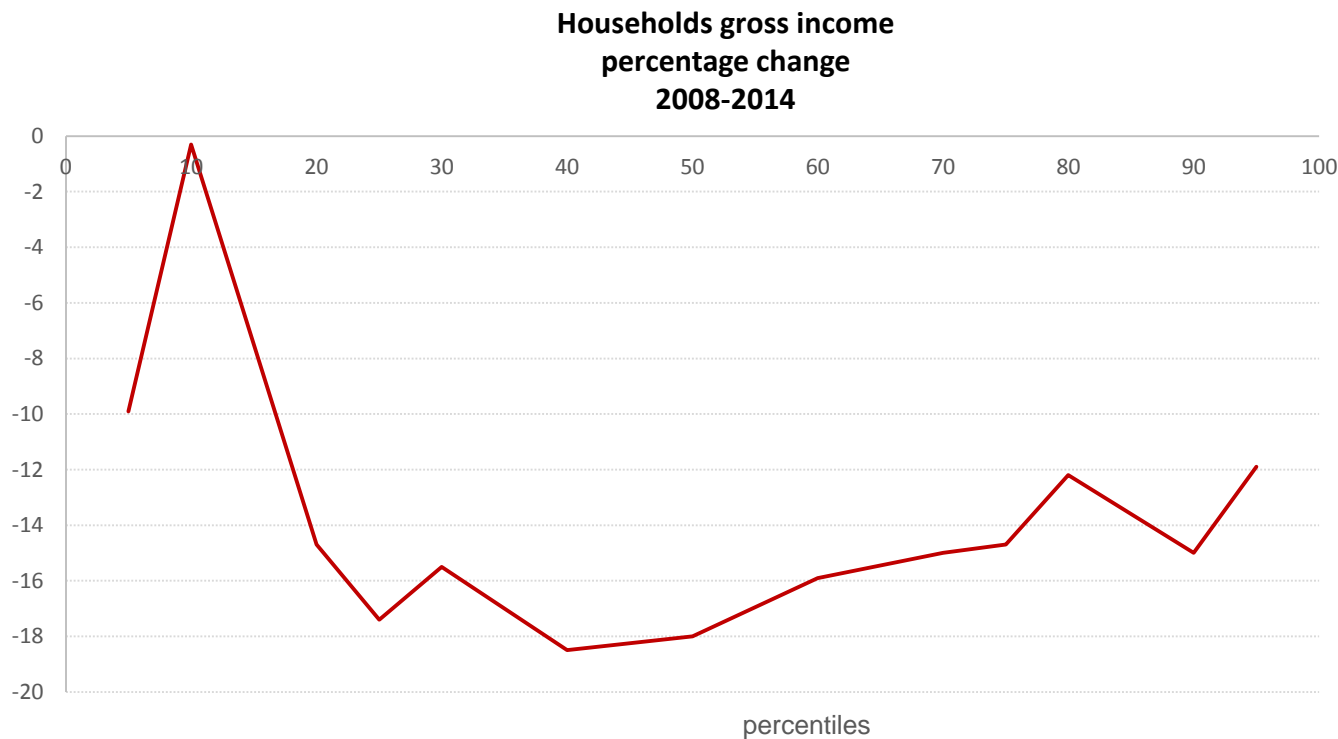
1 Increasing wage earning inequality



Source: Labour Force Survey

A closer look at inequality performance in Spain during the crisis

2 Pension and other transfers (unemployment benefits) have limited the impact of the crisis in households with the lower income



Source: Households Financial Survey and Bank of Spain

- ❖ Lower share of wage earnings in low-income households and redistributive policies have allowed a lower gross income decrease than those suffered by higher percentiles

A trend to stay?

Piketty (2014)

Average capital returns exceeds economic growth

Scheidel (2017)

Traditional level off mechanisms less frequent

Baldwin (2016)

Wage convergence in services sector unavoidable

Whatever the answer: serious implications for economic policy

Populism

- ❖ Populist governments spreading
- ❖ Short-term policies by populist governments
- ❖ Increasing lack of trust in institutions weakens ownership of policies and boosts economic nationalism

Economic efficiency disruptions

- ❖ Efficiency- equality trade off ineffective
- ❖ Several transmission channels
 - Financial (Rajan): intendedness and wider economic cycle
 - Consumption (Mian and Sufi): higher impact on GDP (marginal propensity to consume)
 - Decapitalization (Perotti): lower access to education and health lead to lower economic growth

Personal reflections

Will the monetary union survive to a new crisis?

Euro are still a fragile monetary union where large divergences in economic performance persist

Limited progress and reluctance to address the coordination failure

To what extent has the financial system improved?

Significant progress in building up capital buffers: stability of the banking system improved

But many of the planned reforms have been abandoned or with limited progress

Does inequality and populism threaten economic stability?

Inequality must be factored in into the discussion about the vulnerabilities also in advanced economies

Inequality must be taken into account in the design of economic policies, fiscal policy included



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