

The way ahead: economics and policies in the enlarged Europe

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The European Union and the rest of the World

	Population (2005) (% of world)	GDP at PPP (2005) (% of world)	GDP per head (2005) (EU27=100)	GDP growth (1998-2007) (% per annum)
EU27 (Euro area)	7.6 (4.9)	20.4 (14.8)	100.0 (112.5)	2.4 (2.1)
Neighbours* (Russia)	10.9 (2.3)	8.5 (2.6)	29.1 (42.1)	4.2 (5.4)
United States	4.6	20.1	162.8	3.1
Other advanced (Japan)	4.5 (2.0)	13.9 (6.4)	115.1 (119.2)	1.8 (1.3)
Emerging economies**	60.8	34.5	21.1	6.1
(China)	(20.7)	(15.4)	(27.7)	(9.1)
(India)	(17.3)	(6.0)	(12.9)	(6.6)
(Brazil)	(2.9)	(2.6)	(33.4)	(2.4)
Other developing***	11.6	2.6	8.3	4.3
World	100.0	100.0	37.2	4.1
-G7****	11.4	41.2	134.6	2.4
-BRICS*****	43.2	26.6	23.0	7.8

* Rest of Europe (including Russia and other CIS countries), Middle East and North Africa.

** Developing Asia and Latin America

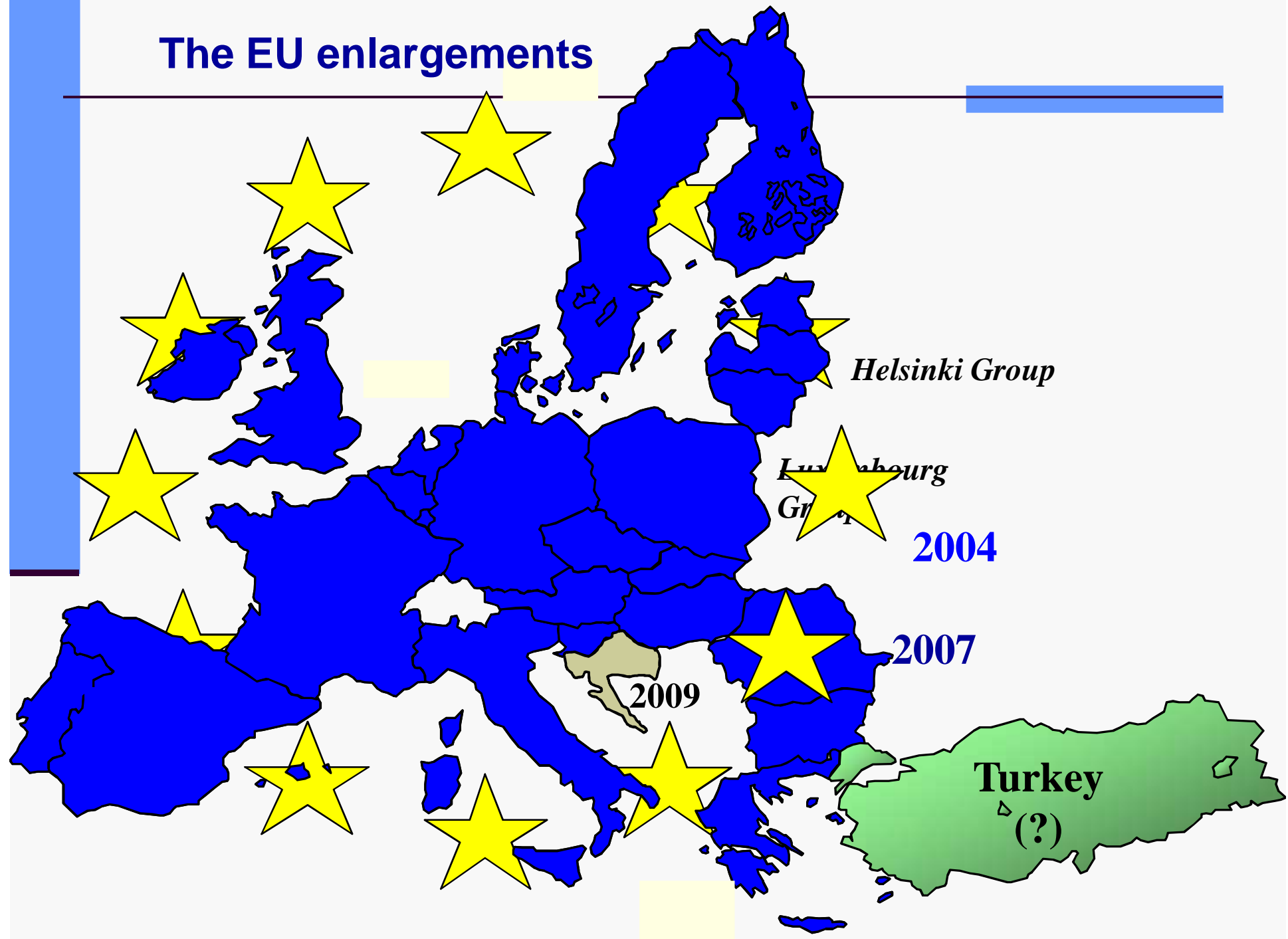
*** Sub-Saharan Africa.

**** Canada, France, Germany, Italy, Japan, United Kingdom and United States.

***** Brazil, Russia, India and China.

Source: Sapir (2007).

The EU enlargements



CONSOLIDATED VERSION
OF THE TREATY ESTABLISHING
THE EUROPEAN COMMUNITY

Tools

Article 2 (ex Article 2)

The Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing common policies or activities referred to in Articles 3 and 4, to promote throughout the Community a harmonious, balanced and sustainable development of economic activities, a high level of employment and of social protection, equality between men and women, sustainable and non-inflationary growth, a high degree of competitiveness and convergence of economic performance, a high level of protection and improvement of the quality of the environment, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States.

Objectives

Growth – Stability – Cohesion as the main EU objectives

Outline of the Seminar

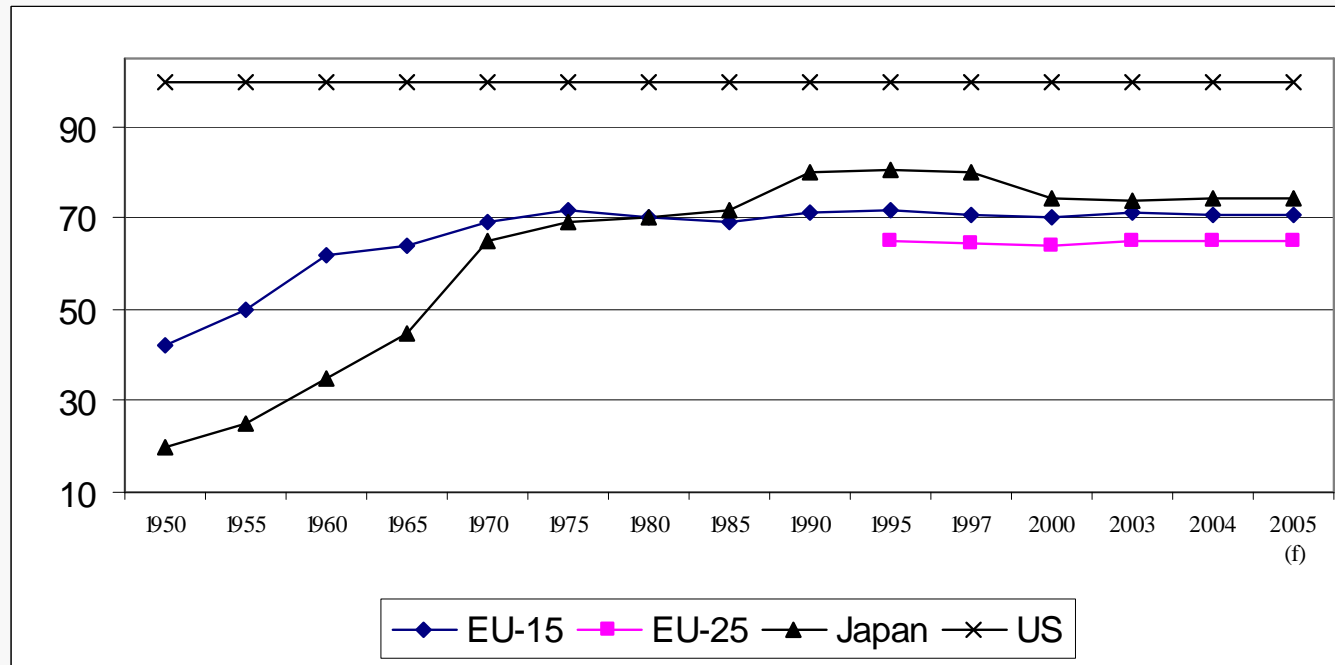
1. To what extent Growth – Stability – Cohesion have been achieved in the EU

- *have the tools (single market – EMU – common policies) been successful insofar ?*
- *how does the current global economic situation affects the ability of the EU to deliver these three objectives ?*

2. What lies ahead in terms of broader challenges for the EU ?

GROWTH

GDP per capita in PPS for EU-15, EU-25 and Japan, 1950-2005 (US=100)



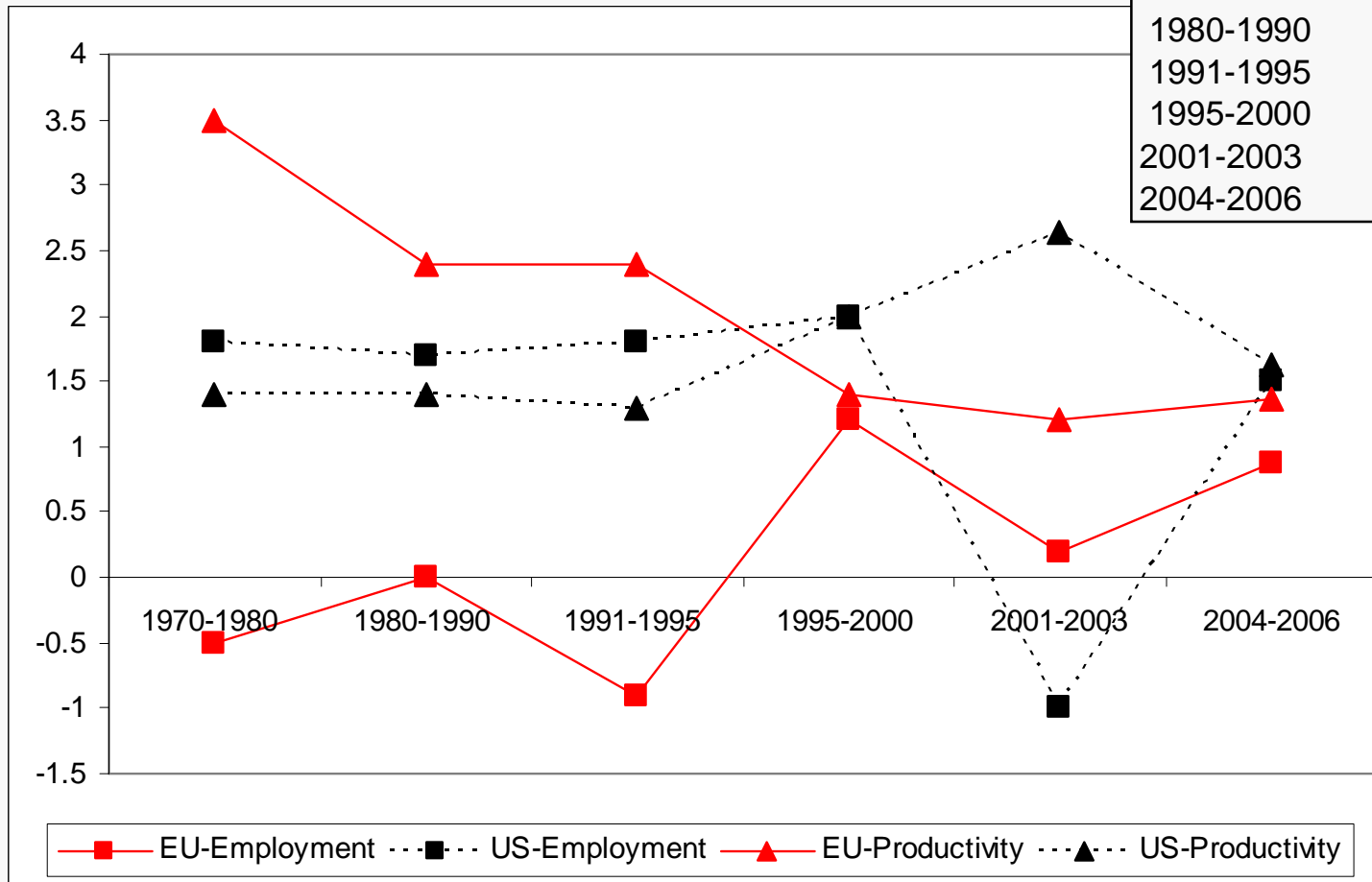
Source: Altomonte and Nava (2005), Chapter 5 on the basis of Sapir et al. (2004) and Eurostat data. Values for 2005 are forecasts.

GROWTH: Employment and productivity, 1970-2006, EU vs. US

$$Y = L * (Y / L) \Rightarrow \frac{DY}{dt} = \frac{DL}{dt} * Y/L + \frac{D(Y / L)}{dt} * L$$

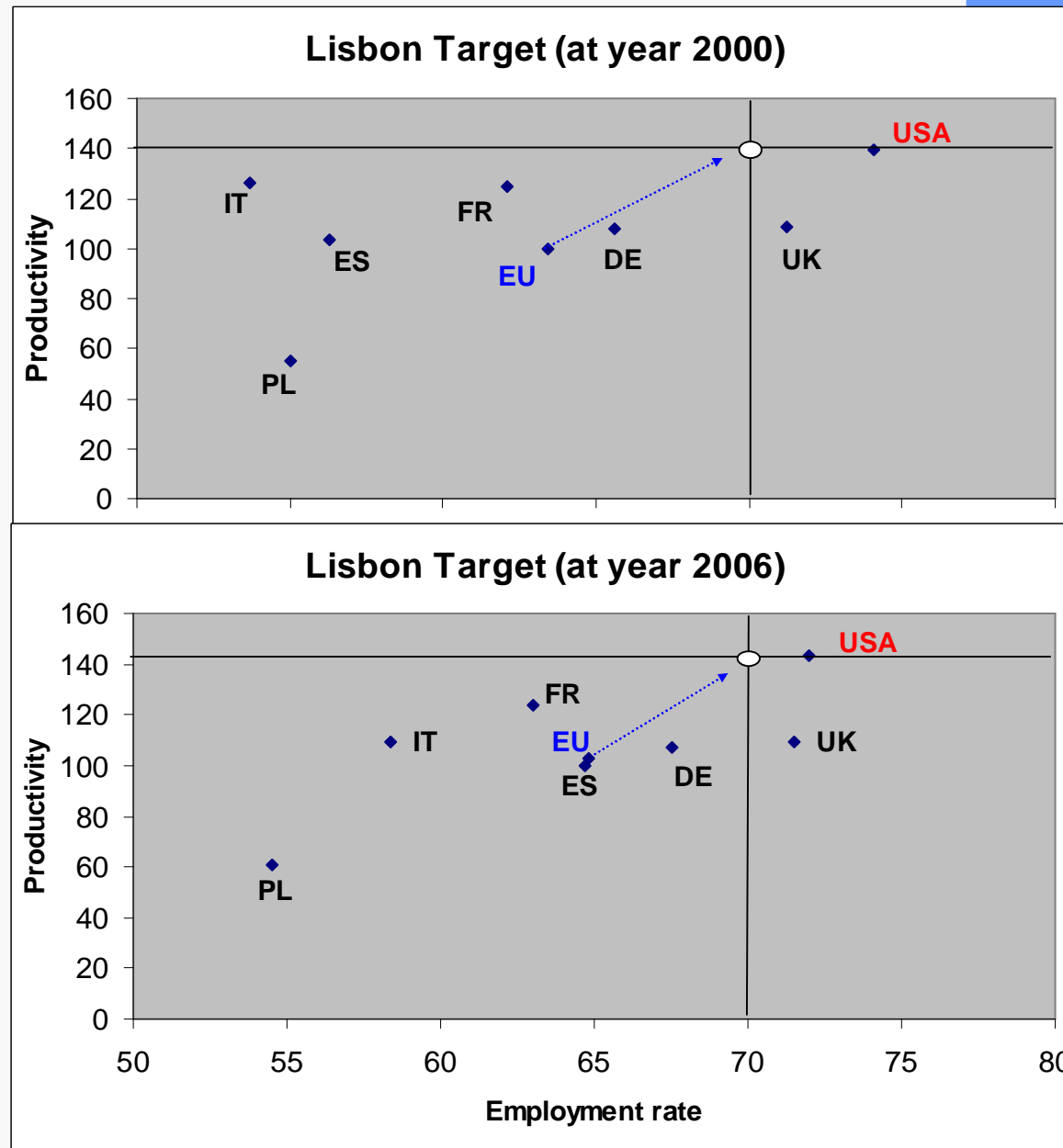
Growth = labour growth*Y/L + productivity growth*L

	EU-GDP	US-GDP
1970-1980	3	3.2
1980-1990	2.4	3.2
1991-1995	2.1	3.6
1995-2000	1.5	3.1
2001-2003	1.4	1.6
2004-2006	2.2	3.1



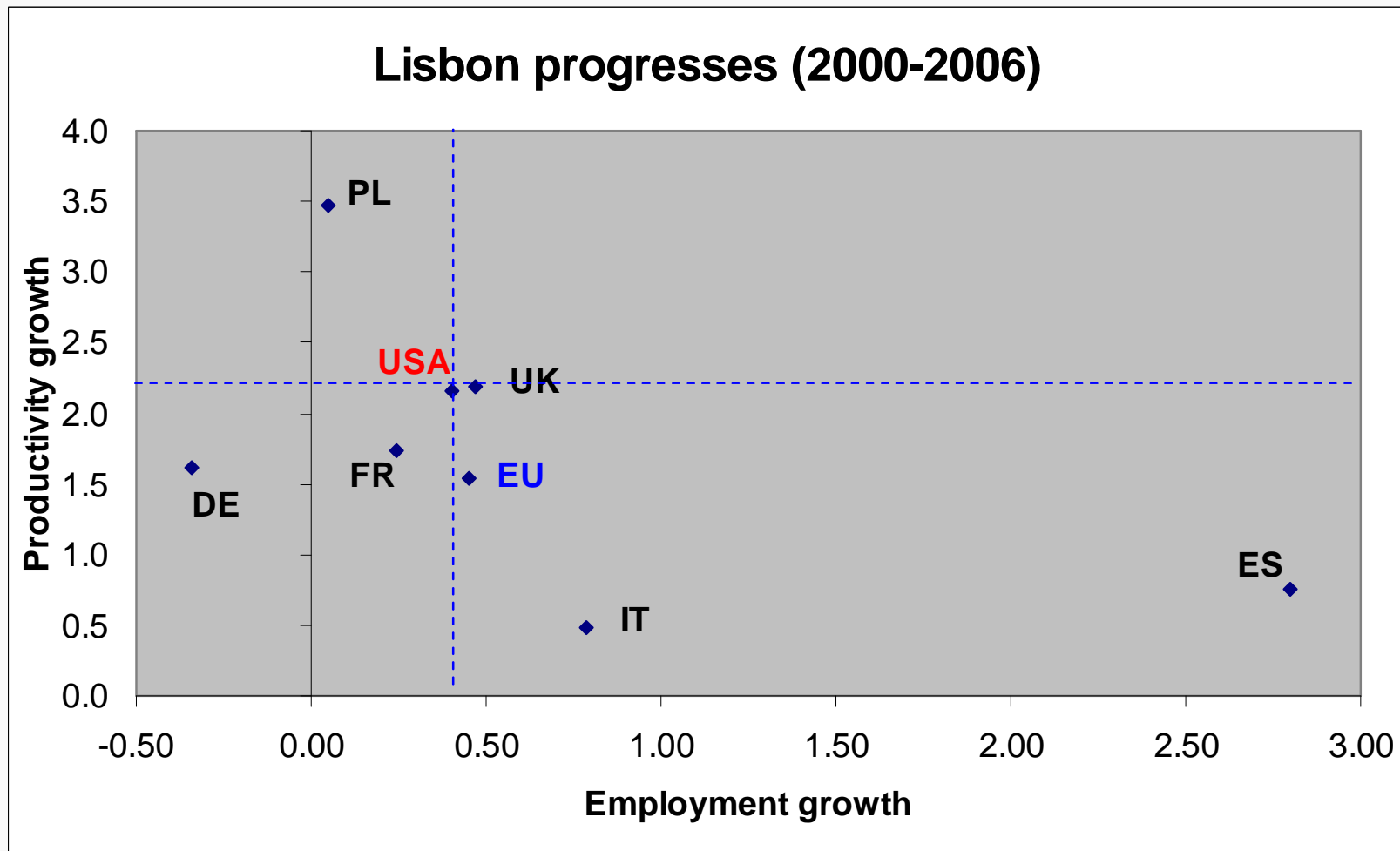
Source: updated from Altomonte & Nava (2005) on the basis of Sapir et al. (2004). Data source is OECD Productivity Dataset
 DL/dt is measured as annual growth in number of hours worked; D(Y/L)/dt is measured as annual growth of GDP per hour worked;

GROWTH: Country position vs. Lisbon targets (2010)



Source: EUROSTAT

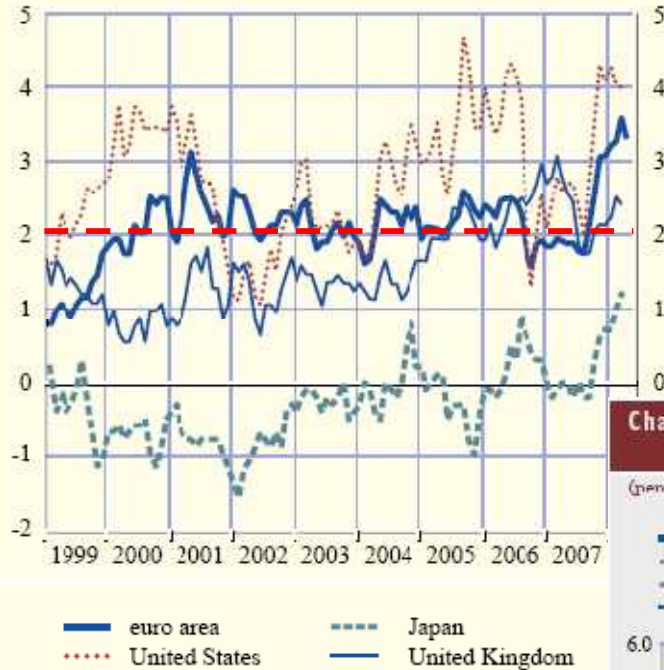
GROWTH: the way ahead



Source: OECD Productivity Database

STABILITY: inflation and interest rates in EU

Inflation rates²⁾
(consumer prices; annual percentage changes; monthly data)



Inflation target of ECB = 2%

Low volatility of inflation and interest rates from 1999 to 2007

What about 2008 and beyond ?

Chart 1 ECB interest rates and money market rates

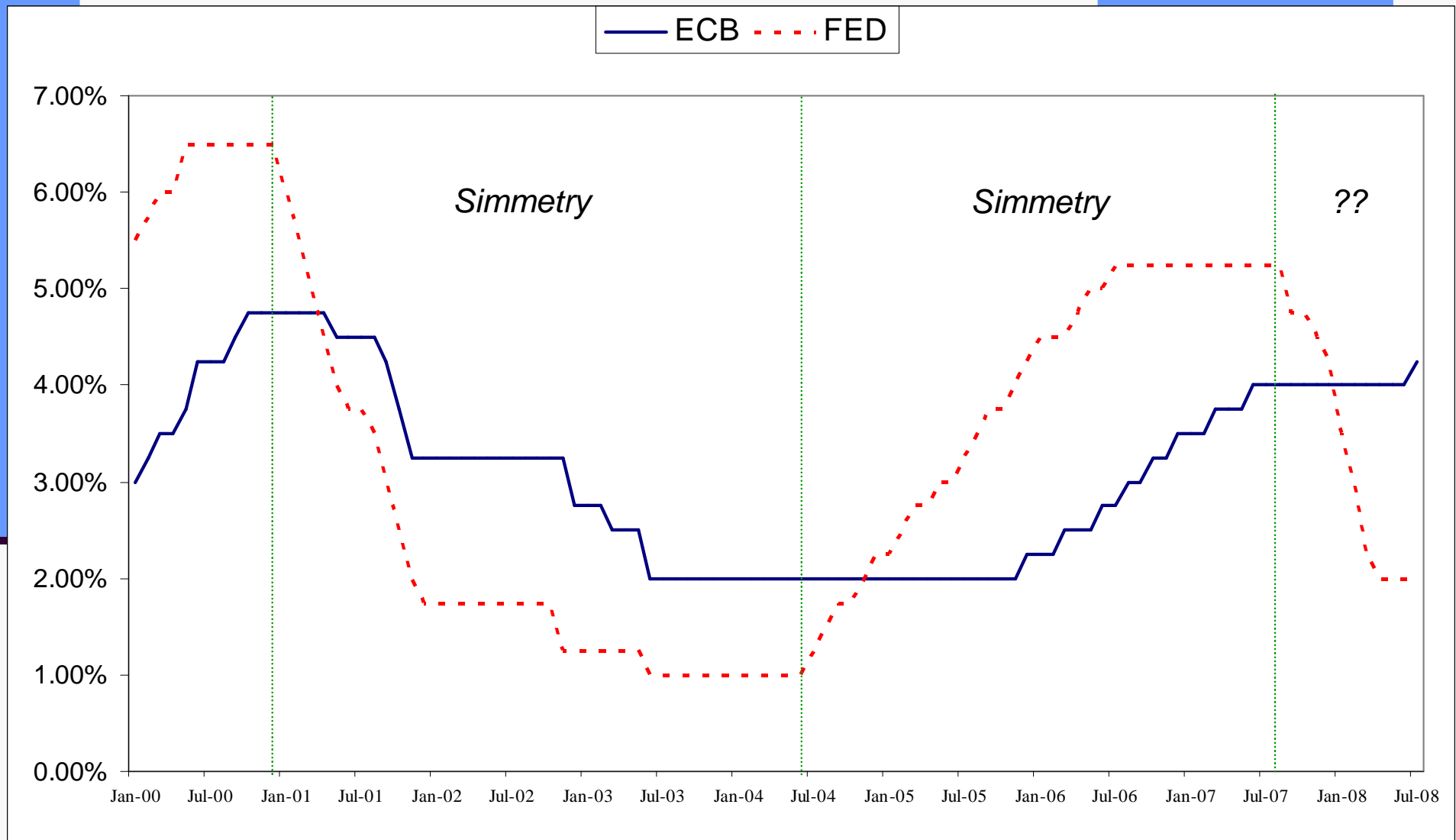
(percentages per annum; daily data)

— minimum bid rate of the main refinancing operations
- - - deposit rate
- - - marginal lending rate
— three-month EURIBOR



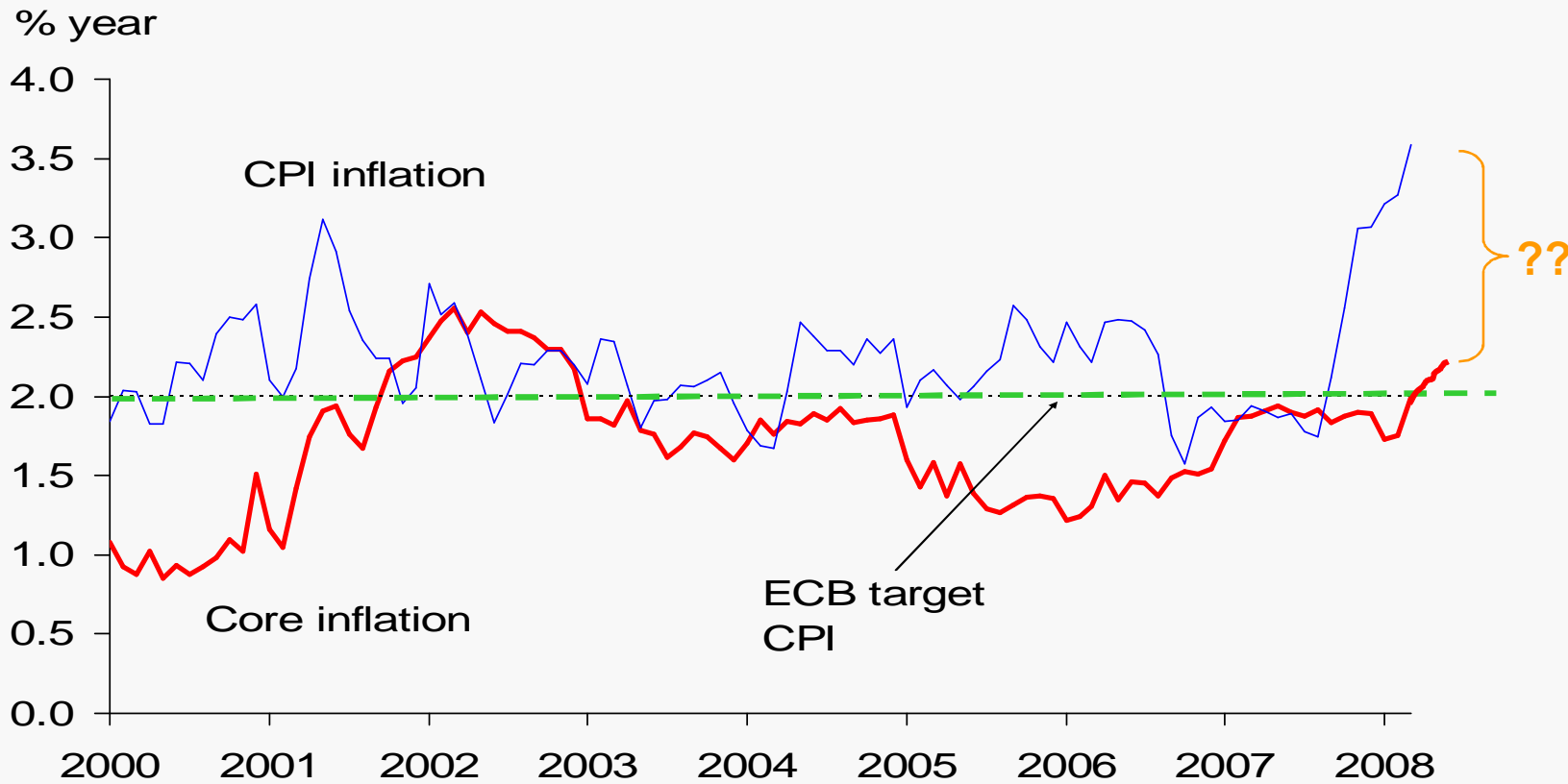
Source: ECB.

The monetary channel of Stability – FED vs. ECB



STABILITY – CPI vs. 'core' inflation

Eurozone: Inflation



- ECB has neglected the raise in CPI, but is now reacting to the raise of core inflation (raising rates). With low, constant rates in US, the asymmetry in EU vs. US monetary policies widens

STABILITY: The Euro exchange rate

Latest (3 June 2008): EUR 1 = USD 1.5593

Change: ▲ +0.0072 (+0.46%)

Select date range: [1m](#) | [3m](#) | [6m](#) | [1y](#) | [2y](#) | [5y](#) | [All](#)

[See EUR vs. USD](#)

Change from 5 January 1999 to 3 June 2008: ▲ +0.3803 (+32.26%)

Minimum (26 October 2000): 0.8252 - Maximum (23 April 2008): 1.5940



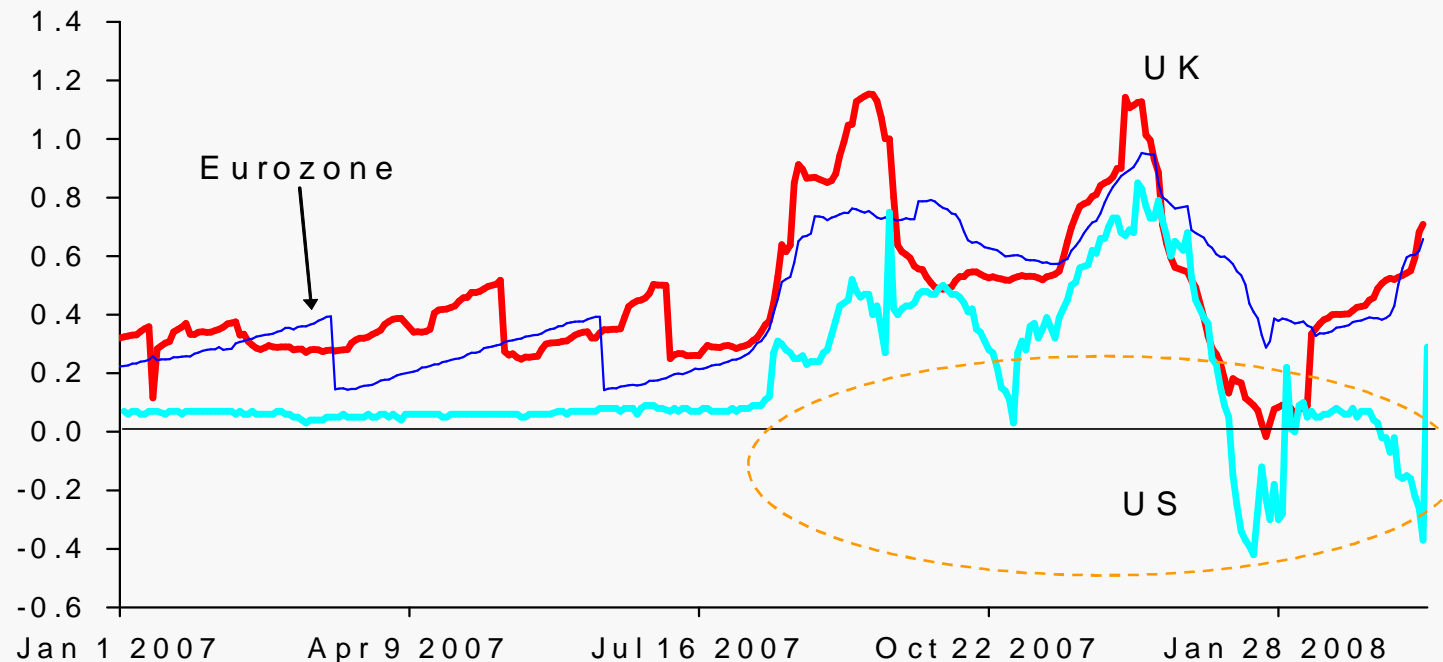
- Asymmetric monetary policies have led to an overshooting of the Euro / USD exchange rate => sustainable ?

STABILITY: the link with Growth

- Credit conditions in Europe remain very tight, putting a negative drag on consumption, and thus growth

Interbank spreads over official rates

3M LIBOR over policy rate, %



Source : Oxford Economics/Haver Analytics

STABILITY: the way ahead

- The FED has started to lower rates as a reaction to the sub-prime crisis, the ECB has kept rates constant until June '08
- The oil shock is creeping into the Eurozone 'core' inflation, forcing a change of course to the ECB monetary policy: the ECB has *raised* rates in July '08, widening the gap with US rates:
 - how hard should the ECB fight the raise in core inflation ?
 - if CPI is (also) a target, since inflationary pressures are external to the Eurozone, should the ECB be able to manage more effectively the Euro exchange rate ex TEC art. 111 ?
 - is the restrictive EU monetary policy, combined with an overly appreciated Euro and (still) tight monetary condition going to cause a severe slowdown in Europe ?
 - can the situation be tackled through an **enhanced coordination of fiscal policies** (like in the US) ?

COHESION: Indicators of total inequality in EU-15 and the World

Indicator	<i>1970</i>	<i>1980</i>	<i>1990</i>	<i>1995</i>	<i>1998</i>	<i>2000</i>	<i>2000 - World</i>
Top 5% / Bottom 20%	2.01	1.73	1.77	1.73	1.86	1.86	16.36
Gini Coefficient	0.32	0.299	0.301	0.303	0.309	0.308	0.657
Theil Index	0.169	0.146	0.154	0.150	0.160	0.159	0.855
- Within-country	0.152	0.130	0.145	0.142	0.152	0.152	0.342
- Across-countries	0.017	0.016	0.009	0.008	0.008	0.007	0.513
Absolute poverty (10\$/day)	10.4	2.2	1.0	1.1	1.1	1.0	23.7
Poverty (20\$ a day)	34.9	20.1	13.8	12.4	9.2	8.7	51.3

Source: Altomonte and Nava (2005), Chapter 5 as elaborated from Morriison and Murtin (2004).

COHESION: the challenge of EU enlargement

Inequality Index (Theil index)	EU15 (2000)	EU27 (2005)	EU27 + Turkey (2005)
“Within-country” inequality	0.152	0.156	0.170
“Across-country” inequality	0.007	0.064	0.085
Total inequality	0.159	0.220	0.255

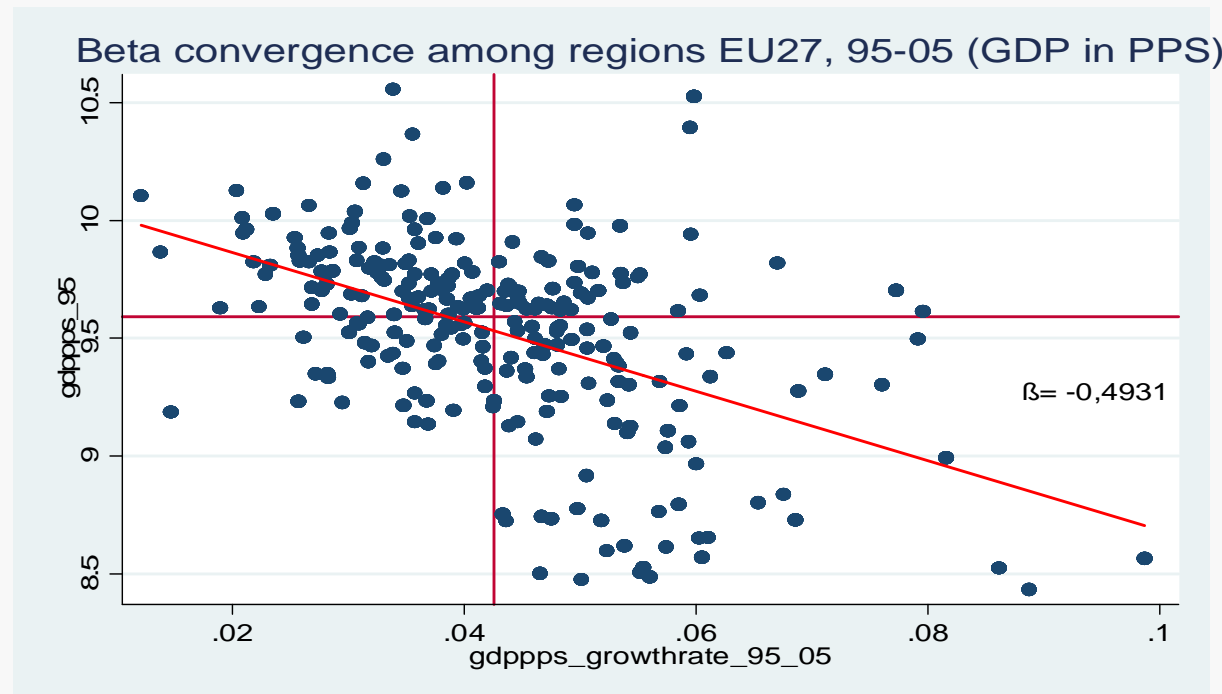
Source: Altomonte and Nava (2005), Chapter 5 as elaborated from Morrisson and Murin (2004).

- A worsening of the EU **cohesion** is the only potential problem to be expected as a consequence of the EU enlargement

=> around 300Bln € of funds have been allocated by the **EU regional policy** to tackle this problem by the EU budget for the period 2007-2013

COHESION: the way ahead

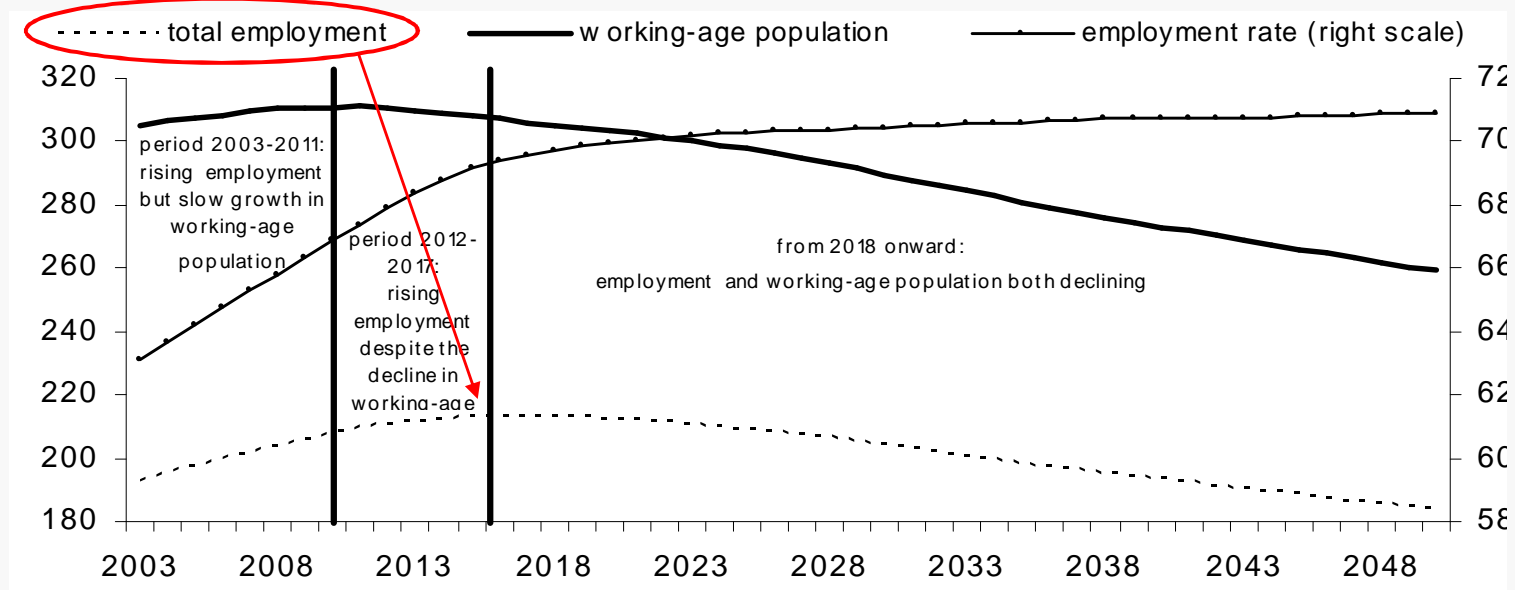
- The EU strengthened regional policy is fostering **cohesion** within the EU-27 countries.



- It remains to be assessed to what extent inequalities within countries will persist in the long run, and what policies are best suited to correct them

Broader challenges: Immigration

Projected working-age population and total employment, EU25

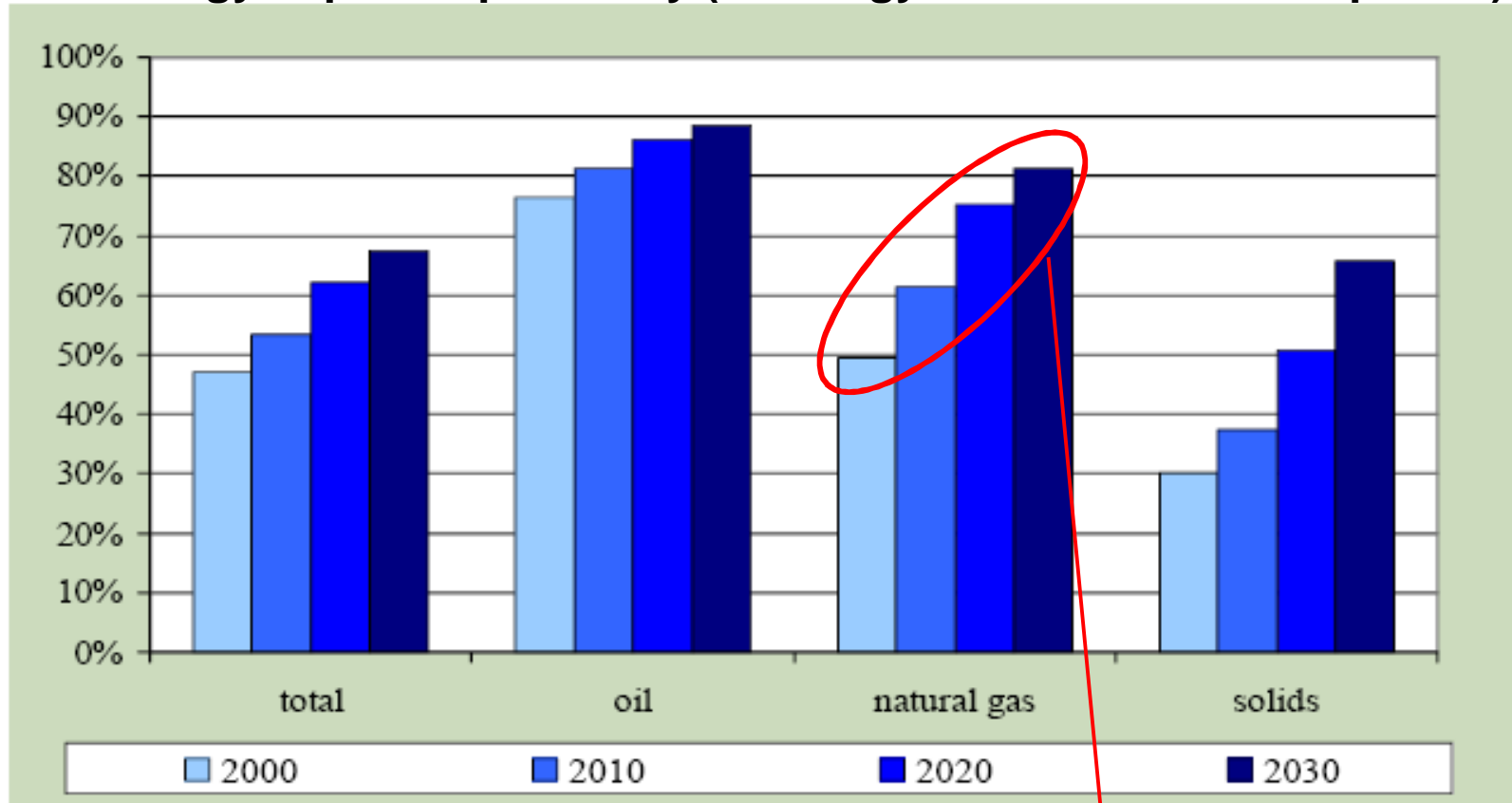


Source: DG ECFIN

- Even if the employment rate target is achieved (> 70%), the demographic dynamics are such that employment in Europe will fall after 2015
- That entails a smaller growth rate for the EU economy unless
 - technology improvements substitute for the smaller n. of workers
 - Immigration flows compensate for that => **European “Blue Card”**

Broader challenges: Energy

EU Energy Import dependency (% energy that needs to be imported)



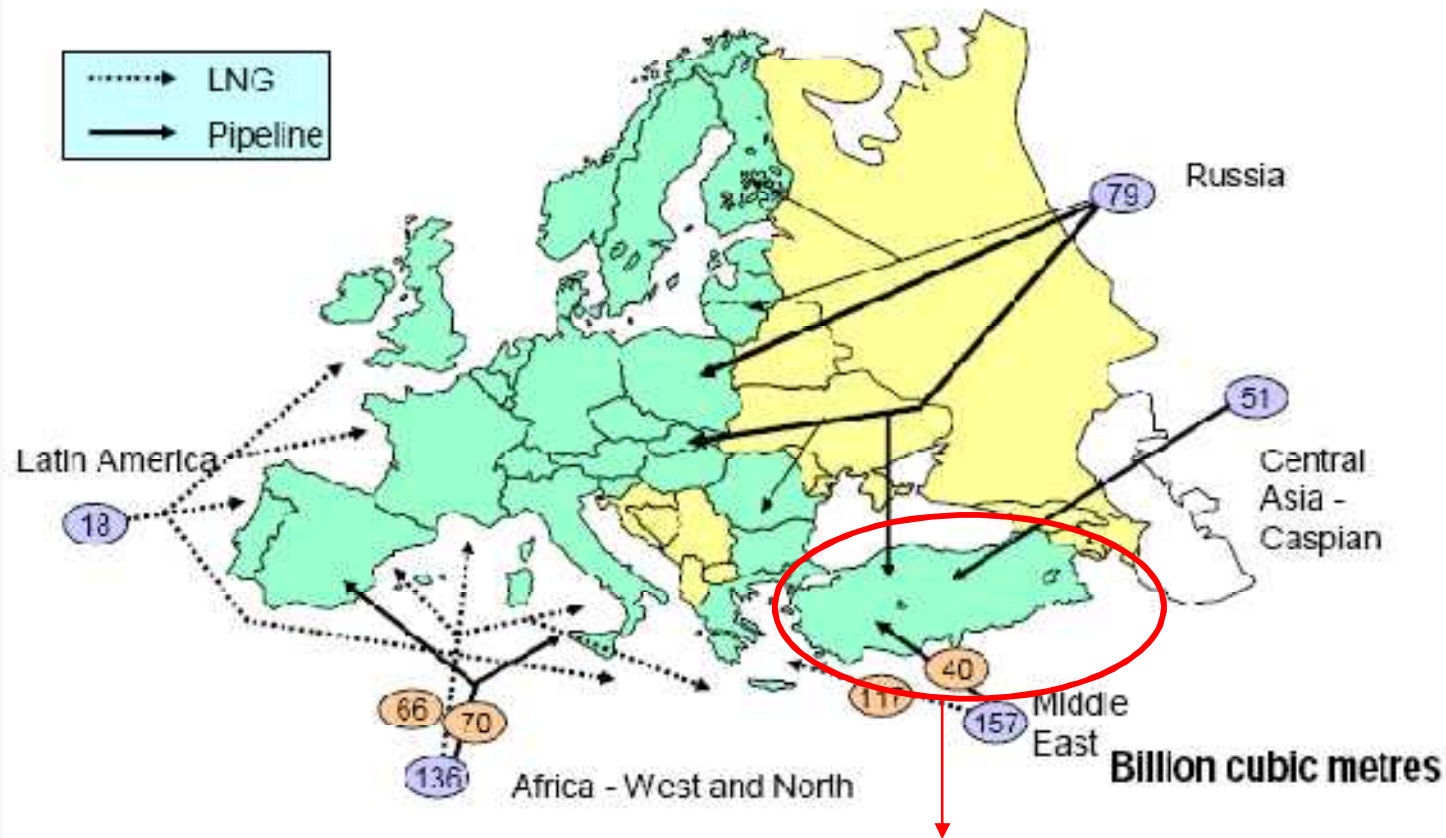
	GAS	OIL
Import from Russia	24%	27%
Import from Norway	13%	16%
Import from the Middle East		19%
Import from Algeria	10%	
Import from North Africa		12%
Indigenous production	46%	21%
Other Regions	7%	5%

From around 200BCM to around 630BCM of imported gas per year in 2030

The Energy geo-politics

Incremental Gas Flows 2002-2030

Reference Scenario : EU-30 (+430BCM per year)



Turkey is a geo-strategic priority

Broader challenges: Common Foreign Policy ?

