GERMAN COUNCIL
of Economic Experts

AIReF
Independent Authority
for Fiscal Responsibility

Second International Conference of Councils on Economic Policy

CONFERENCE TRANSCRIPT

Selected contributions

June 2018

PREFACE

To provide a platform for international exchange, the German Council of Economic Experts (GCEE) initiated a first International Conference of Councils on Economic Policy in 2016. The aim of the platform is to foster the communication and cooperation regarding issues of economic policy among similar institutions all over the world. After the successful first edition of the conference on June 24, 2016 in Berlin, the second International Conference of Councils on Economic Policy took place on June 9, 2017 in Madrid and was hosted by the Independent Authority for Fiscal Responsibility (AIReF). Participating councils in this second conference included:

Conseil d'Analyse Économique (France),

Council on Economic and Fiscal Policy (Japan),

CPB Netherlands Bureau for Economic Policy Analysis,

Economic Council (Finland),

German Council of Economic Experts,

Independent Authority for Fiscal Responsibility (Spain),

Irish Fiscal Advisory Council,

Office of Parliamentary Budget Officer (Canada).

In addition to the representatives of the various national economic councils, Niels Thygesen, chair of the European Fiscal Board, joined the discussions.

The contributions to the conference concentrated on two major issues: the threats of protectionism to free trade and globalization including the resulting implications for economic policies and the international institutional framework as well as the future of the European project against the background of economic nationalism trends.

This volume collates a selection of the papers which formed the background for the individual conference presentations, prefaced by a welcome address given by José Luis Escrivá, Chair of the Independent Authority for Fiscal Responsibility.

José Luis Escrivá, AIReF Christoph M. Schmidt, GCEE

CONTENTS

INTRODUCTION

José Luis Escrivá

INTRODUCTORY REMARKS

This second edition of the International Conference of Councils on Economic Policy addresses two issues currently at the top of the academic and political debate: globalization and the future of the European project. With this aim the Conference has been organized in three sessions. In the first two sessions, government economic advisers are given the chance to exchange views on the challenges to globalization and the future of the European project while policy options available to face these challenges is the focus of the last one.

The global economy is at a critical juncture since the early 2000´s. Several factors have been a drag on trade, productivity, income growth and financial stability. Trade opening is not progressing like before in traditional areas as well as services or digital trade while bilateral and regional trade agreements are proliferating. There are signs of protectionist practices as the weakness of the WTO dispute settlement and negotiating function proves. Moreover, President Trump´s approach in renegotiating bilateral changes to multilateral agreements has the potential to revive US unilateralism in international trade.

Strong pressures from the losers of globalization are emerging. Globalization is leaving too many individuals behind with trade opening the dominant factor in developing economies and technical change in advanced economies. The losers from globalization are a natural constituency to vote in favor of nationalist and protectionist policies, seeking shelter behind national borders. The classical divide between the right and left is now less relevant. The big divide is on globalization between the winners and losers.

Against this backdrop, the first session focuses on the main developments recently observed when discussing whether there is a real threat of a reversal in globalization.

- What are the main factors behind recent economic nationalism trends?
- What are the key challenges to globalization?
- What are the implications for economic growth prospects for the world economy and the different geographical areas?

The second session intends to address the more specific challenges faced by Europe and the future of the European Union project against a background of economic nationalism trends. In particular, five initial challenges have been identified. First, Brexit is a crisis in the European project. The economic impact is expected to be low in the short term. While in the long-term depends on future negotiations of a new agreement. These negotiations require striking a balance between maintaining market access and setting the record straight on past commitments. Second, migration is a controversial and difficult challenge for Europe. Recent events show the lack of a coherent and clear policy towards migration as well as refugees fleeing the violence of war.

The rise of populism is a third challenge. Populist parties are a serious threat to the continuity of mainstream parties in government. They also challenge the European project by proposing to renationalize areas of sovereignty previously shared. Fourth, the legacy of the crisis and of previous imbalances is a heavy burden for many EU member states. The main backlog of the crisis in most EU countries is a permanently lower level of GDP and higher number of people out of work as output losses will not be recovered and the labor force has diminished. In addition, potential output growth has also declined between half and a full percentage point, following longer term trends that predate the crisis. High levels of public and private debt inherited from the crisis years, as well as large amounts of non-performing loans in parts of the banking sector, remain sources of vulnerability.

Lastly but not least, despite the reshuffling of the architecture of the Eurozone after the sovereign debt crisis, the task is not yet finished and there is a widespread skepticism about the credibility of the framework. There are two routes whereby stronger credibility of the framework and national policy commitments can be achieved. On the one hand, there is the possibility of complete decentralization of decisions to the national level and rigid enforcement of the no-bail out clause, thus opening the possibility of government debt default. On the other, centralization at the EU level of key budgetary and economic policy decisions with substantial transfers of sovereignty is an alternative option. The Reflection Paper on the future of EMU presented by the European Commission on 31 May does not put forward precise steps for the immediate future but just a generic map of initiatives.

The final session examines the implications for economic policies and the international institutional framework of a reversal in globalization. According to the WEO many of the challenges that the global economy confronts call for collective action including preserving an open trading system; safeguarding global financial stability; achieving equitable tax systems; continuing to support low income countries development goals; and mitigating and adapting to climate change. The debate could be focused on the first two areas: trade and financial policies addressing issues such as:

- What are the options for monetary, fiscal, trade and financial policies?
- What would be the impact for exchange rates, exchange rate policy and global disequilibria?
- Is it necessary to reform the architecture of international institutions?

Nobuo Kagomiya

FREE TRADE VS PROTECTIONISM: IS THERE A REAL THREAT TO GLOBALIZATION?

Many countries are experiencing widening income inequality and shrinking manufacturing sectors. While both globalization and technological change have contributed to these phenomena, the effects of the latter are considered to be stronger than the former. Bearing this in mind, I would like to show some findings in Japan related to the effects of globalization.

- Japan's share in world exports has halved from the nearly 10% level around two decades ago.
- Among major export industries, the automobile is still very competitive, while a substantial part of their exports has shifted to FDI. On the other hand, some final products of electric machineries lost their competitiveness.
- As a partial reflection of changes in the division of labor in Asia, where China increased its production of higher-value-added goods, Japanese exports to China recently decreased.
- The share of manufacturing sector in both the employment and value-added has decreased in Japan as well as in other countries.
- As well as other OECD countries, the relative poverty rate tended to increase in Japan over the past two decades.

However, in Japan, political reaction to globalization is relatively limited. Some possible factors related to this can be:

- improving labor market conditions with the unemployment rate around 3% (even though there are some profound labor market problems such as the dichotomy between regular and non-regular workers)
- the main reason behind the widening income distribution is the composition effect caused by Japan's ageing population, i.e. an increase in the share of older households that have higher poverty rates. (Compared with it, the effects of globalization is considered to be relatively smaller.)
- smaller share of foreign population

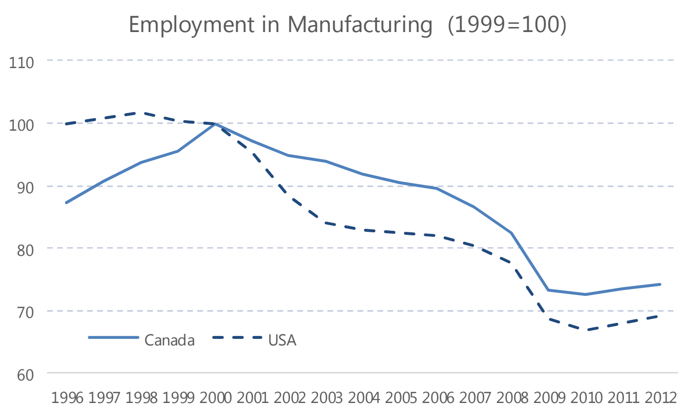
Philip Bagnoli

SOURCES OF PROTECTIONIST PRESSURE

Background

For the five decades starting with the 1950's, employment in United States' manufacturing sector had been roughly constant, but with some fluctuations. After 2000, the United States and Canada lost, respectively, a third and a quarter of manufacturing jobs in the following decade (Figure 1).

FIGURE 1: EMPLOYMENT IN MANUFACTURING

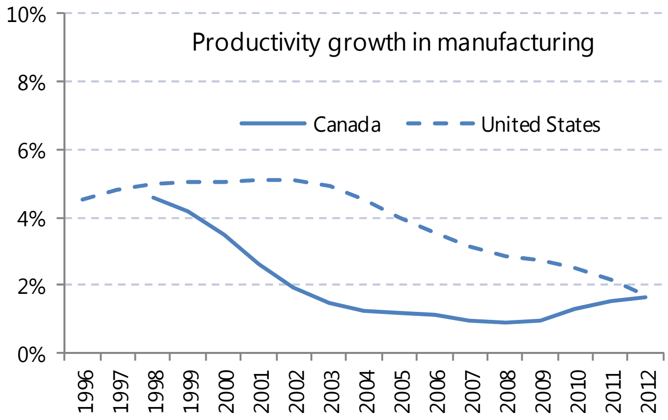


From an economic perspective, the central question concerning that trend is what was underlying it? Was it trade, technology, or something else? First, note that between 2000 and 2009, demand for manufactured goods in the United States fell by some 15 per cent (Source: Federal Reserve Economic Data; Haver Analytics). So a little less than half of manufacturing job loss would have occurred *ceteris paribus*.

The influence of technology

A key observation is based on a simple intuition. That is, implementing newer technologies should lead to a productivity boost. But there wasn't one – productivity growth in manufacturing slowed (Figure 2). This creates a puzzle for advocates of a technology-led decline in employment.

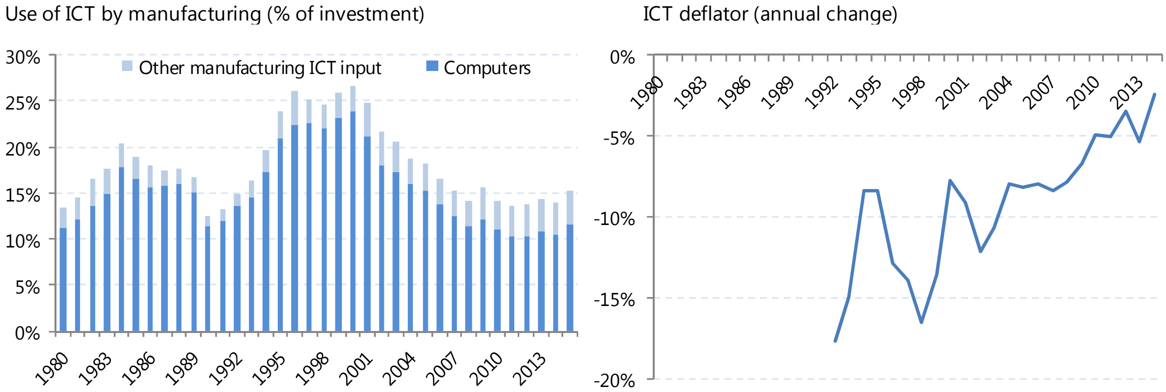
FIGURE 2: THE TECHNOLOGY PUZZLE



Source: Federal Reserve Economic Data; Haver Analytics

As background, note that investment in computers and ICT equipment in general rose in the United States during the 1990s and stayed at an elevated level through to 2001 (Figure 3a). It then began a decline that lasted until 2011. That decline was magnified by the slowing of quality improvements in computers and related electronic equipment (Figure 3b). So at a time when expenditure growth was decreasing, the rate of increase of quality improvements obtained through those purchases was also slowing.

FIGURE 3A, B: ICT AND MANUFACTURING



Source: Federal Reserve Economic Data

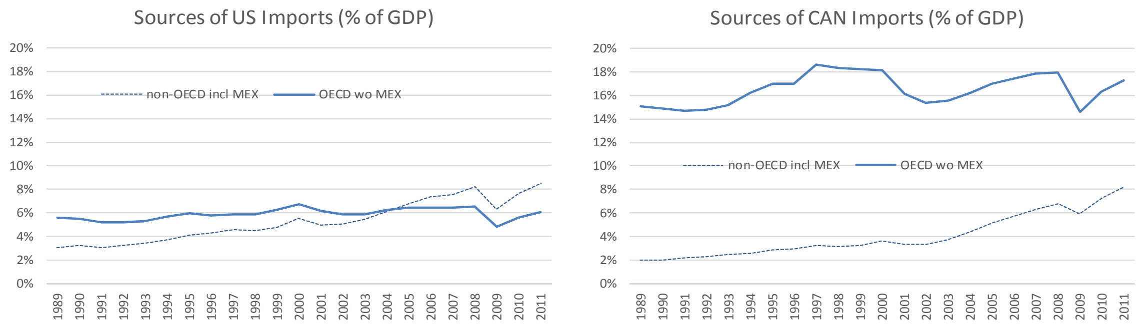
This makes the link between technology improvements and the decline in employment challenging to maintain. If new technologies had indeed eliminated the need for workers, that should have begun during the 1990s. Instead, a more traditional complementarity between technological change and labour use occurred from the mid-1990s as productivity improved. This subsequently broke down after 2000.

Note also that the experience across other countries was mixed in terms of employment loss. Looking at other OECD countries with comparable data, many had decreases in employment of more than 15 per cent between 2000 and 2009 (e.g. United Kingdom, Demark, Portugal, Spain, Sweden). But manufacturing powerhouses such as Germany and Japan experienced decreases of less than 15%, so technological advance in manufacturing is difficult to sustain as the cause of employment loss without simultaneously asserting that those countries are falling behind (Source: OECD labour force data).

The influence of trade

An important event that occurred before the decline in manufacturing employment was the entry of China into the WTO. This expanded the sources of lost-cost manufacturing – at the same time that Mexico increased its exports to Canada and the United States. From 2001 to 2008, both Canada and the United States increased their import share from non-OECD plus Mexico by 3 percentage points of GDP (Figure 4a,b). This was a significant acceleration of imports from lower-wage countries. Non-OECD countries plus Mexico now supply the majority of imports into the United States, and are rapidly increasing their share in Canada.

FIGURE 4A,B.

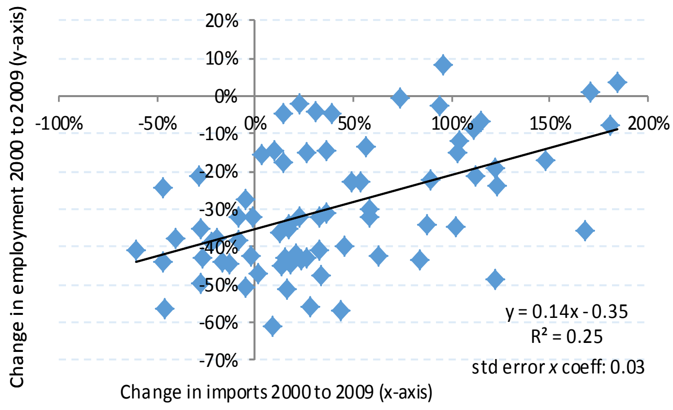


Source: Comtrade database

The increase in imports is thus coincident with the loss of employment. That suggested connection, however, is not as straightforward as it would appear. The manufacturing sectors can be sub-divided into 75 separate sectors and each examined for its correlation between employment and imports. Doing so reveals an empirical link that runs counter to common perceptions; i.e. there is a tendency for increased imports to be associated with *increased* employment (Figure 5). For proponents of the view that imports lead to job losses, this is a counterintuitive result.

One explanation for this result is that intra-firm trade is important, and expanding firms were more likely to be expanding trade.

FIGURE 5: CORRELATION BETWEEN CHANGE IN EMPLOYMENT AND CHANGE IN IMPORTS



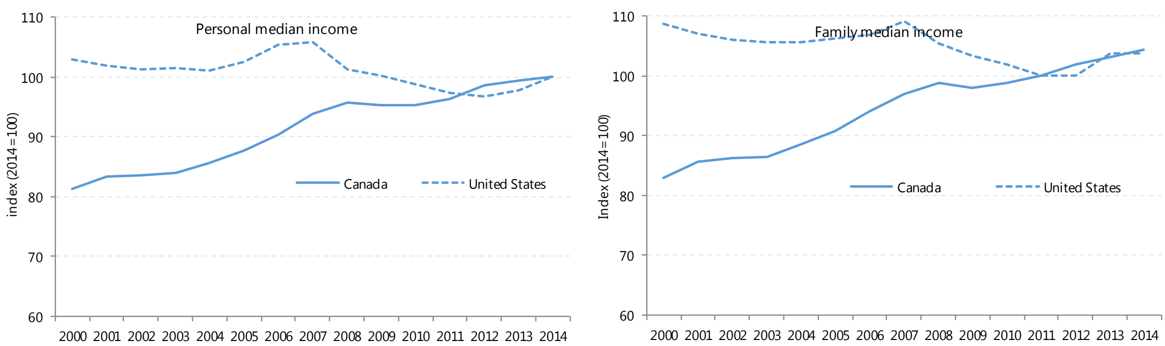
Source: US ITC database

Some recent work found evidence that wages in industries and geographical regions where imports were concentrated tended to fall (Autor, et al, 2016). This leads to the conjecture that imports were a contributor to stagnant median family incomes since 2000. Nonetheless, this observation does not preclude the positive link between imports and employment; it may be that a compositional change in employment occurred that might underlie the above result.

Other concurrent developments

Though both Canada and the United States experienced increases in imports from lower-wage countries, it was coupled with diverging experiences in the domestic economy. In Canada there were continued increases in median incomes, while in the United States it coincided with a falling median personal income (Figure 6).

FIGURE 6: MEDIAN INCOME, CANADA AND UNITED STATES



Source: Federal Reserve Economic Data; Canada Census data

This difference contributes to the disillusionment with liberalized trade that appears particularly sharp in the United States, and has led to calls for renegotiating trade agreements.

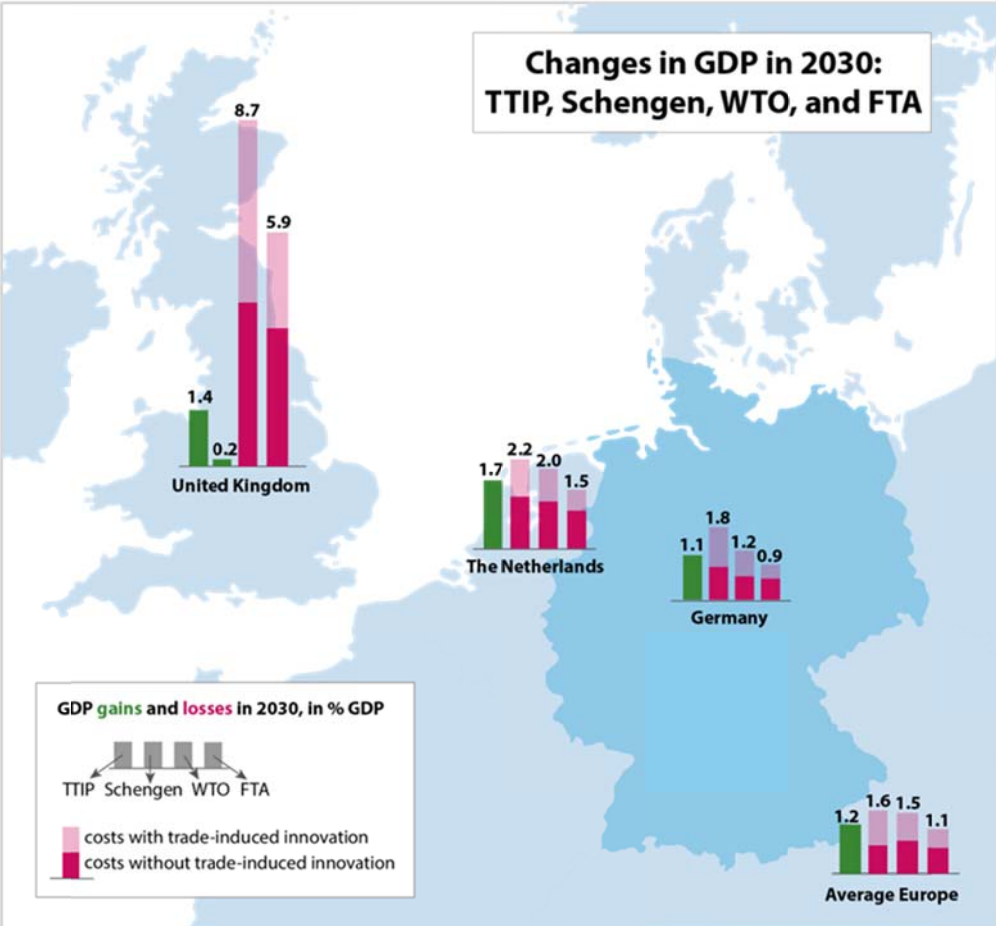
Laura van Geest and Johannes Bollen

BREXIT AND THE FREE MOVEMENT OF PEOPLE

Summary

In June 2016, a majority of British voters chose Leave in the Referendum on EU membership. At CPB we undertook an analysis of the implications of Brexit using World Scan, a model specifically geared towards the analysis of trade regimes. The implications for the UK economy were sizeable, depending on the specifics of the future relationship (FTA or WTO) and on the presence of innovation effects (see figure 1). However, Brexit will not only affect the economy thorough trade, but also through migration. The new arrangement is still unclear. However, if migration flows since the EU enlargement were to be reversed, our estimates show an additional cost of around 1% of GDP.

FIGURE 1: EFFECTS OF BREXIT



Drivers of migration

Opportunity differentials are at the heart of most migration, also within the EU. Some people are more likely to move than others. Being young, better educated, male, and living in a city are attributes associated with mobility. The choice of destination is influenced by a variety of social and economic factors. Work restrictions (none Ireland, UK, Sweden, Germany / Austria only from 2011). Better economic opportunities, including large wage differentials, low unemployment, and considerable labour demand, explain the significant flows from Eastern Europe to the United Kingdom and Ireland following the 2004 and 2007 EU enlargements. Existing migrant networks explain why Romanian nationals have mainly settled in Spain and Italy. Low familiarity with Scandinavian languages is one reason why immigration to these countries has been relatively small in scale, despite their generous welfare systems and (until recently) comparatively positive economic outlook.

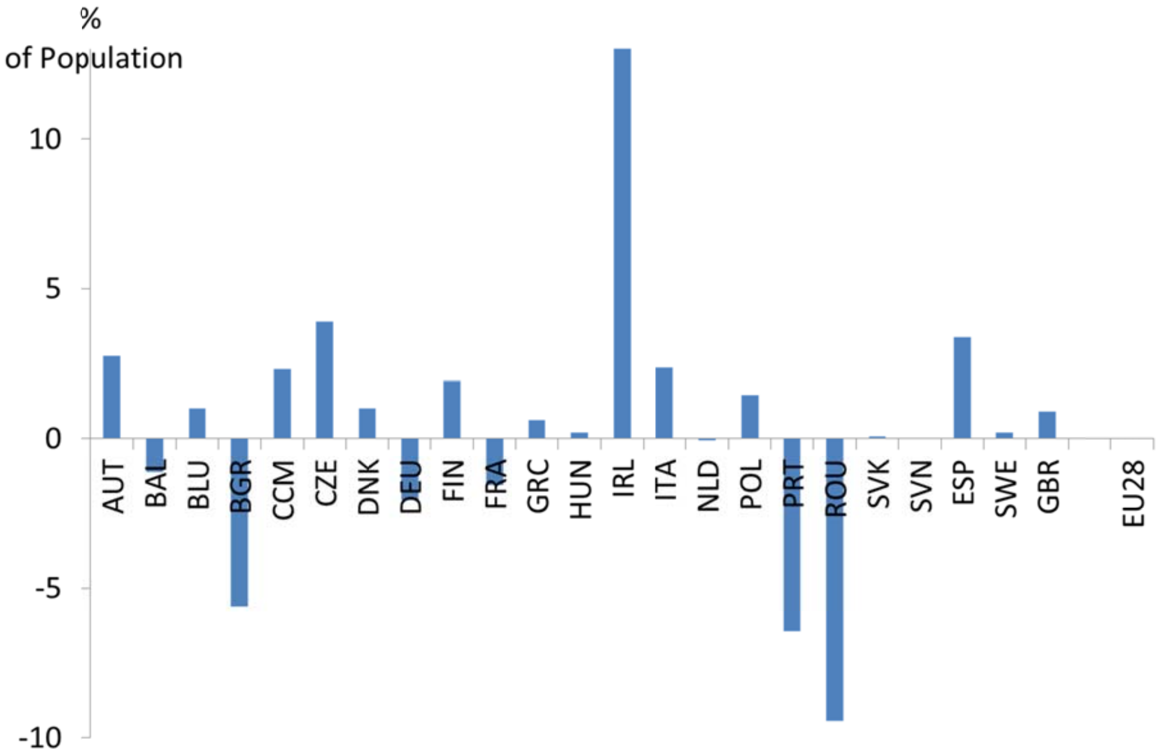
Costs and Benefits of migration

Receiving countries get contributions to public finances, support for the development of new industries and new jobs. But migrants compete for jobs with local workers and bring earnings down if they work for a lower wage. This leads to 'distributional effects' that differ in effect depending on cycle. Sending countries get extra capital into the country through remittances, while labour outflows can alleviate unemployment through the removal of labour surpluses. However, the loss of more-skilled workers ('brain drain') or shortages caused by large worker outflows from certain sectors can stunt the economy.

Our Estimates

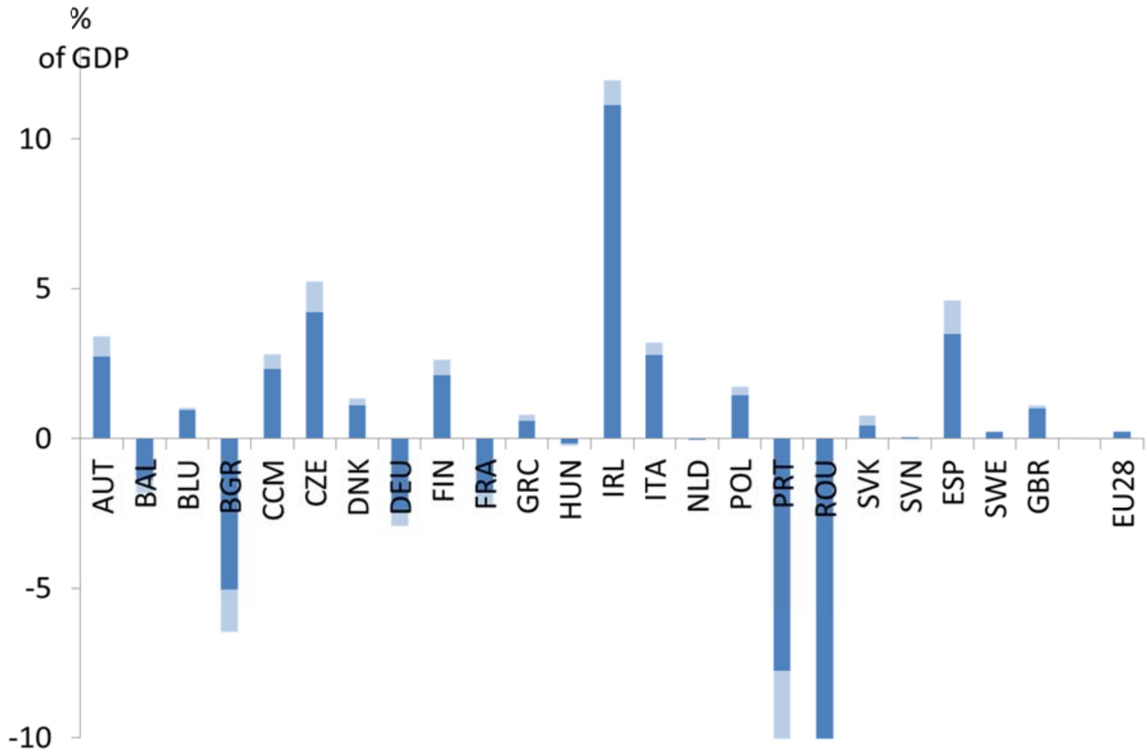
Using global bilateral migration flow data from the World Bank, we estimated net migration flows in the EU (2004-2013). This is migration flows, since the major enlargement of the EU.

FIGURE 2: MIGRATION FLOWS 2004-2013



Next we calculated the costs and benefits of migration in a simple approach (refraining form remittances), using World Scan (a General Equilibrium model (with micro foundations); Interaction: Markets, Countries (33), Sectors (21)). We assume that immigrants earn the average wage in the host country. In the Neutral Skill variant (dark blue) we assume that migrators' skills resemble the average skills of the departed country, in the High Skill variant (light blue), we assume that migrators are dominated by highly skilled workers.

FIGURE 3: GAINS FROM MIGRATION



The results show a limited gain at the EU level (0.2 % of GDP), but major differences between countries. In Portugal, there is a relatively large difference between the neutral and high skill variant: migrants left mostly for France, Spain & Great Britain (high skill jobs), while in Romania, there is no difference: workers stayed in similar jobs.

Effects for the UK

EU migration in UK involved 0.9 % of the labour supply, of which 80 % are high skilled workers. GDP gains from immigration amounted to 1.0-1.3% of GDP. So if immigration were to be reversed, Brexit costs increase by at least 1% GDP.

Pekka Sinko

THE FUTURE OF THE EUROPEAN PROJECT – A SMALL COUNTRY PERSPECTIVE

After Britain's resignation, European Union will be even more than before characterized by small member countries which makes it distinct from the other major economic powers, USA and China. It can therefore be instructive to evaluate the recent developments and prospects of EU in the light of economic theory on country size.

The work done by e.g. Alesina (2003) suggests there is a major trade-off between benefits of size and the costs of increased heterogeneity of preferences that determines the optimal country size. However, openness to trade can serve as an important means for the small countries to reap the benefits of scale through increased market size without loss of homogeneity of preferences.

The main benefits of size to countries relate to reduced cost of public goods per citizen, bigger market size and lower risk of foreign aggression. Prosperity of small countries requires a peaceful environment and economic integration. To achieve this, small countries are ready to give up some powers to multinational organizations while at the same time retaining independent discretion in policy areas where preferences tend to be more heterogeneous (education, culture, social security, taxation etc.).

The era after WW2 witnessed a fast increase in the number of small independent countries coupled with trade liberalization and – in particular after 1990s – a reduced risk of military conflicts. Small countries have also fared well in economic terms and been the main beneficiaries of globalization (Figure 1). From this perspective, European Union provides a framework within which smaller nations can become prosperous through gaining from a larger market size. So far EU has provided less benefits in terms of security and joint provision of public goods.

The lack of common EU defence has led many small European countries to seek shelter through membership in the NATO. If materialised, a weaker US commitment to European defence will basically increase the optimal country size within the union. This is why small countries are likely to become more interested in developing EU's own defence in the future.

European Monetary Union can be seen as a public good that reduces transaction costs and prevents competitive devaluations, but it also entails costs by excluding member states' individual needs to adjust their monetary policies. Small countries are exposed to exchange rate speculation and externalities and may therefore gain more from fixed rates. On the other hand, the cost side may also be larger for small countries because common monetary policy is likely to reflect the economic circumstances in the larger countries.

Altogether, small countries may not be any more prone to enter a monetary union than bigger ones. Nevertheless, the fact that after Brexit the Euro area will become more dominant within the EU as a whole is likely to make EMU membership more attractive – for purely strategic reasons – even for those small countries still outside the currency area. Progress of the Banking Union is particularly welcomed by small countries whose own economic resources are often limited relative to the financial institutions located in the country but doing business internationally.

Fiscal policy integration involves policy areas where preferences are more heterogeneous and therefore is basically a less attractive form of cooperation to small countries. In addition, loss of fiscal policy independency may be more serious to small countries, because they tend to face a stricter market discipline and therefor have to be more careful in making commitments that may risk public finance sustainability. Also, similar to monetary policy, integrated fiscal policy is more likely to fit to the needs and actual circumstances of the larger economies. On the other hand, one could argue that taken far enough, fiscal policy integration might help small countries to reduce the volatility of public funds caused by openness and specialization[1].

In summary, small countries are particularly interested in securing peaceful environment and increasing the size of their markets while retaining discretion in policies where preferences are more heterogeneous and/or costs of integration are considered too high. As for the future of EU and EMU, this line of reasoning seems to support more integration in the financial markets and more national level discretion in fiscal policy as suggested recently by e.g. Calmfors (2017). However, if global supply of security and market access becomes scarce, small countries will be more prone to make concessions in terms of reduced discretion in other policy areas.

It is possible to view the recent developments in globalization and immigration as shocks that exacerbate the problem of heterogeneous preferences in the big countries. Examples of this include the sharp geographical division of the UK in the Brexit-vote as well as support for Donald Trump in the US election. Since big countries have less to gain from multinationalism, they are more likely to opt out after such shocks and this exactly what we have seen recently for both countries.

[1] I thank Agnès Bénassy-Quéré for bringing up this point during the discussion in Madrid.

SHARE OF GLOBAL GDP 1980-2016

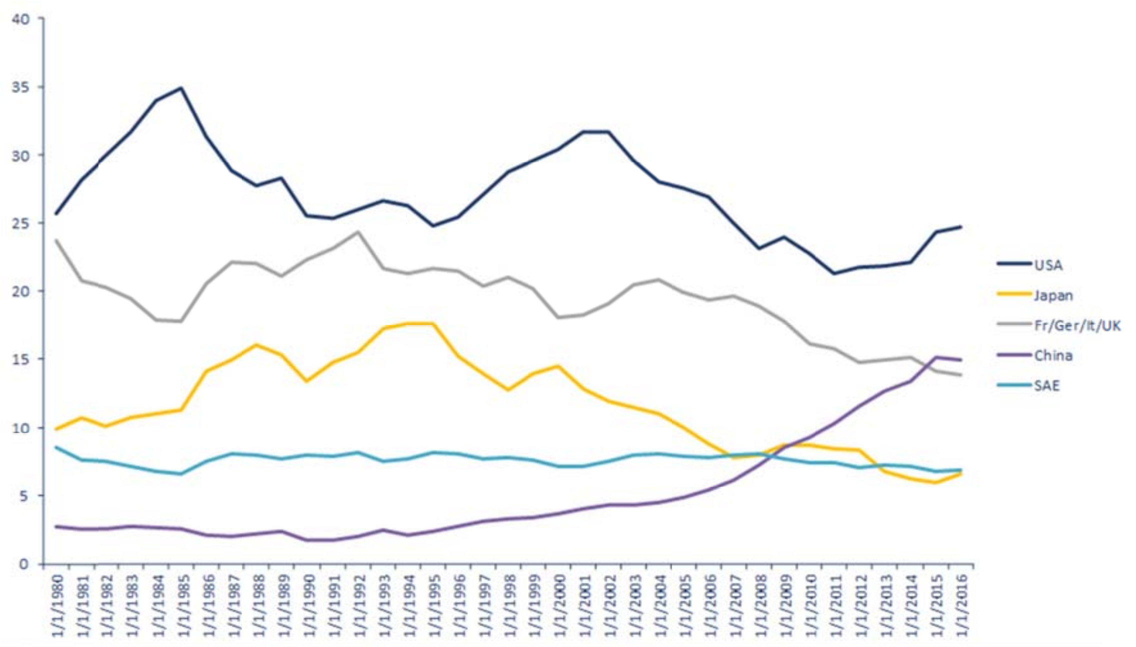


Figure 1 Small advanced economies (SAE) have held their share of global GDP roughly constant since 1980 while many bigger developed countries have seen a trend downwards. Group SAE covers 23 advanced countries with populations of less than 20 million. Source: Skilling (2013).

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Christoph M. Schmidt

THE FUTURE OF THE EUROPEAN PROJECT AGAINST A BACKGROUND OF ECONOMIC NATIONALISM TRENDS

In the wake of the French presidential elections, economic researchers and politicians are once again called upon to devise strategies for re-invigorating the European project. This advice has to be formulated in the midst of a situation which is threatening the very viability of this project. While in previous years this challenge had come in the form of member states already having lost or being on the verge of losing access to sovereign bond markets, now nationalism raises similar concern.

And once again, this creates a trade-off between addressing today's problems effectively and avoiding to implant the seeds for future conflict while doing so. Thus, whatever institutional reform is implemented today, it should be regarded as a persistent element of the future architecture of the Euro area. In consequence, it should pass a strict test of sustainability, or it should not be implemented at all.

This strict test has to be applied, a fortiori, to all suggestions put forth to counter the centrifugal forces currently being amplified by new nationalism. It tends to disqualify any proposal to prematurely jump into an institutionalized supranational collaboration, such as a Euro area-wide fiscal capacity or unemployment insurance scheme. Proposed measures should on closer inspection qualify as viable elements of a sustainable architecture. They should not be taken up just to provide a political signal of goodwill, whenever they lack economic rationale,.

In essence, doubts regarding sustainability arise whenever the desirable congruence between decision-making power ("control") and the responsibility for the consequences of these decisions ("liability") diverge. It would be quite naïve to presume that member states' decisions remained unaffected by the possibility to transfer part of the costs of their choices to other member states. This possibility will always tend to arise with the implementation of a fiscal capacity or of a joint unemployment insurance, irrespective of the honorable intentions leading to their implementation.

This does not at all imply that the process of European integration would have to stop. To the contrary, there are many fields for fruitful collaboration which could send this political signal of goodwill while addressing externalities in an economically sensible fashion. Three intimately related principles can help identify these promising topics:

– First, the European project derives its particular strength as a guarantor of peace and as an engine of prosperity from respecting the diversity of its members. Learning from one another, adopting approaches which work and abstaining from those which fail, requires a rich reservoir of ideas, not a unified approach.

– Second, the process of peaceful integration requires local and regional preferences to be balanced with the internalization of externalities and the economies of scale provided by harmonization. The principle of subsidiarity can help finding the ideal balance, as it requires – policy field by policy field – authority to be allocated to the most decentralized level which can solve the ensuing problems effectively.
– Third, to avoid any conflict between those making the decisions and those paying for their consequences, one should strive for congruence between control and liability. This, again, should be discussed policy field by policy field.

Applying these principles to the future of the Euro area immediately points to a wide range of policy fields where joint policy action is sensible. Among those are climate policy, asylum policy, counter-terrorism and efforts to complete the single market. A joint fiscal policy or a common labor market policy, however, do not qualify for this list. Concentrating harmonization efforts on the more sensible policy fields is the best way to revitalize the process of European integration.

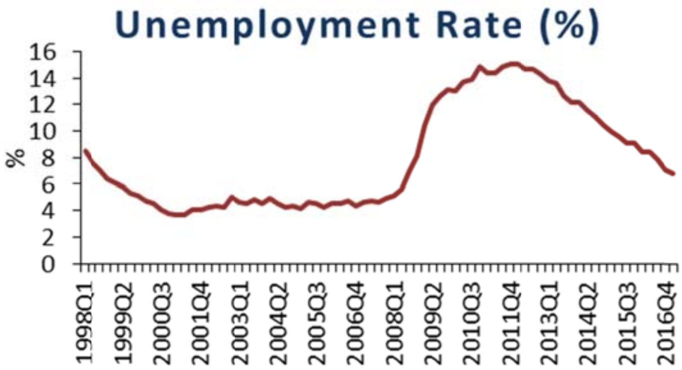
Pursuing integration instead for the mere sake of providing political signals against nationalistic tendencies is an avenue headed for disappointment. That would likely deliver inferior economic results and lead to permanent asymmetric transfers and more distributional conflicts. Finding consensus on issues such as climate policy will be more difficult and require more political capital than the formation of yet another superfluous financing vehicle for public investments. But it holds a large promise: to help ascertain a more prosperous and less adversarial Europe.

Seamus Coffey

ECONOMIC NATIONALISM IN IRELAND: RIDING THE BICYCLES OF CO-OPERATION AND COMPETITION

Introduction

The Irish economy is one that is characterised by unusual volatility. During the late 1990s and early 2000s the unemployment rate rapidly declined from double-digit levels to four per cent where it stayed until 2008 as Ireland experienced joint credit and constructions booms. These ended abruptly in 2008 and the unemployment jumped to 15 per cent. Since 2011 the unemployment has fallen sharply and by the middle of 2017 was down to six per cent with further falls expected.



The ever-evolving status of the Irish economy means that the backdrop to any debates on economic policy are heavily influenced by the country's position in the business cycle. Fiscal policy has tended to be pro-cyclical which has exacerbated the boom-bust swings.

Cooperation and Competition

All countries will exhibit some degree of economic nationalism but vary in how they seek to achieve it. Some may look for enhanced co-operation with other countries while others may go down the road of competing with other countries. Ireland attempts to ride both of these bicycles.

Through the European Union Ireland favours co-operation which gives access to markets far larger than its own. Irish exports are equivalent to 125 per cent of GDP. Alongside this co-operation Ireland engages in competition for investment, particularly for investment from US MNCs using a 12.5 per cent rate of Corporation Tax. As long as Ireland can maintain this somewhat contradictory stance support for the European Union will remain high and a more insular type of economic nationalism is unlikely to gain a foothold. Ireland's form of economic nationalism involves strengthening ties to globalisation rather than severing them.

The Beneficiaries of Ireland's Industrial Policy

Domestic support for such an outward looking industrial policy depends on whether the benefits are perceived to be fairly distributed. In some senses the benefits are narrowly distributed. Eight per cent of employment (100,000 jobs) in the business economy in Ireland comes directly from US multinationals while over 13 per cent of personnel costs in the business economy (€6.5 billion per annum) arise from these firms. These direct contributions by US companies are between three and four times larger than the median contribution of US companies to the business economies of the EU. However, employment and wages are by their nature concentrated in who receives them.

The revenues generated by Corporation Tax are a central part of the debate but also how benefits of the industrial policy can be distributed more widely. Although Ireland has a low rate of Corporation Tax, receipts are substantial and amounted to 2.8 per cent of GDP in 2016 well above the EU average. About 80 per cent of Irish Corporation Tax is paid by foreign-owned firms with US companies making the largest contributions. Only half of the profits by US companies make in the EU are recorded in Ireland. Corporation Tax revenues for 2017 are expected to be €8 billion. This is equivalent to almost €4,500 for each of Ireland's 1.8 million households. The use of these funds disperses the benefits of the chosen industrial policy.

Contribution of US companies to business economies[1] of the EU15, 2014

	Gross Operating Surplus	Personnel Costs	Persons Employed	Gross Investment in Tangible Goods*
Belgium	8.2%	7.2%	3.1%	4.2%
Denmark	4.3%	4.4%	3.1%	2.5%
Germany	4.3%	4.5%	2.2%	3.4%
Ireland	56.8%	13.3%	8.3%	10.2%
Greece	0.7%	1.4%	0.4%	0.4%
Spain	2.8%	3.6%	1.7%	4.0%
France	2.8%	4.5%	2.3%	2.0%
Italy	2.4%	4.4%	1.9%	2.8%
Luxembourg	14.7%	7.6%	5.4%	5.2%
Netherlands	10.5%	7.6%	4.0%	5.7%
Austria	2.8%	3.2%	1.7%	1.8%
Portugal	2.5%	3.6%	1.7%	1.7%
Finland	-0.1%	3.8%	2.1%	5.0%
Sweden	3.6%	4.1%	2.8%	1.3%
United Kingdom	9.3%	9.2%	6.0%	5.9%
Mean (ex. Ire)	4.8%	4.8%	2.6%	3.3%
Median	3.7%	4.4%	2.2%	3.4%

Source: Eurostat
1 The business economy is NACE sectors B to N, excluding K, and S95
*Excluding NACE N Administrative and Support Service Activities

The pattern of income inequality is also important. Ireland is unusual in that it is one of the few OECD countries with a lower gini coefficient now compared to 30 years ago. From 1987 to 2007 Ireland experienced rising incomes and falling disposable income inequality. From 2008 to 2012 incomes fell while inequality remained stable. Since 2012 incomes have been rising but there has been no noticeable change in inequality though the latest income-distribution data only go to 2015. If income equality returns to its pre-crisis downward trend this would further buttress the support for Ireland's blend of economic nationalism.

Migration and Brexit

One consequence of the opening up of the Irish economy has been a changed experience with migration. Historically, Ireland was a country characterised by emigration with large Irish communities establishing themselves in other English-speaking countries. This changed in the 2000s and is linked to the strong performance of the Irish economy and the expansion of the EU at that time. In 2001, just five per cent of the population had been born outside the country but by 2011 this had jumped to 13 per cent and has remained there since. However, this increase has not led to any significant anti-immigrant sentiment or the desire for a more insular approach to economic management. History matters, it seems, with recognition that significant numbers of Irish migrants have arrived in other countries most notably during the 1840s, 1950s and 1980s. A large of the employees of the foreign MNCs operating in the country are foreign born but this has had little impact on support for the country's FDI-led industrial policy.

Though EU integration and migration were important factors in the decision of the UK electorate to back exiting the European Union there is little or no desire in Ireland to follow suit. Ireland would obviously prefer if the UK remained as a member of the UK but the UK's exit is not a threat to Ireland's membership. The crucial issue for Ireland is the border with Northern Ireland. A 'hard' border is unacceptable for many reasons most notable of which is the desire to avoid anything that could be a step towards a return to conflict, no matter how remote that may seem. On trade, Irish policy is geared for a 'hard' Brexit but the declining importance of the UK market for Irish exports means access to the EU as a whole weighs larger.

Conclusion

Ireland has a mixed approach when it comes to economic nationalism that combines cooperation and competition. It is a risky strategy but one that is currently very successful and is favoured by a large majority of the population and the main political parties. Continued support will depend on the level of benefits being generated and the distribution, both perceived and real, of those benefits across the population.

José Marín Arcas

THE FUTURE OF THE EUROPEAN PROJECT AGAINST A BACKGROUND OF ECONOMIC NATIONALISM TRENDS

The three main challenges to the future of the European project are:

- Declining dynamism and lack of convergence of European economies
- Dysfunctional allocation of competences and resources to levels of government
- Unsustainable policies

The first challenge entail a risk of “Italianization” of the EU economy, characterized by high debt and tax burden, low growth and productivity, a structural duality North-South and a regime of permanent transfers from rich to low income regions. While the necessary reforms to face this challenge in order to increase market flexibility in resource allocation and boost economic growth have to be undertaken at the national level, there is also a need to improve the governance of the EU and the euro area for efficiency reasons, rather than for stability reasons of crisis prevention and resolution.

The second challenge is to address the dysfunctional allocation of competences and financial resources to the different levels of government (and independent institutions) in the EU, which is not efficient and not in line the principle of subsidiarity. Additional competences to centralise are internal security, border control, defence spending, climate policy. Additional resources to finance the EU budget are corporate taxes on firms above a certain size and green taxes.

Current policies seem to be unsustainable in a number of areas, from climate change to defence or border control. But the unsustainability of national policies in many member states is reflected in the generally very high debt ratios. It is crucial to proceed urgently to consolidate public finances. A long-term plan to consolidate public finances should deal simultaneously with the legacy of debt overhang, which involves some degree of mutualisation, and the enforcement of fiscal discipline, which involves the setup of a government debt restructuring regime.

Nobuo Kagomiya

IMPLICATIONS FOR ECONOMIC POLICIES AND THE INTERNATIONAL INSTITUTIONAL FRAMEWORK OF A REVERSAL IN GLOBALIZATION

I would like to emphasize three points that should help minimize the adverse effects of globalization and maximize its merits.

1. The importance of the empirical analyses and their publication

More empirical analyses are needed on the effects of globalization and the causes of income inequality. Taking advantage of such analyses, we should emphasize the benefit of globalization and technological change.

2. Necessary domestic policies

Domestic policy measures should be strengthened to support inclusive and dynamic economic growth

- Appropriate macroeconomic policy to ensure stable and dynamic economic growth.
- Raising productivity by strengthening R&D and the development of the fourth industrial revolution. Measures to facilitate adaptation to rapid technological change, for example, education to raise people's ICT capabilities, and retraining in schools and companies are also important.
- Enhancing labor market flexibility.
- Appropriate provision of the safety net for people who have suffered damages. Notice that they should be designed not to hinder labor movement.

3. The importance of international cooperation

International dialogue and collaboration are essential for mutual understanding and for strengthening international cooperation, including regional economic partnership agreements. International organizations such as the WTO, OECD and IMF can play key roles.

Niels Thygesen

FISCAL POLICY IN THE EURO AREA

Fiscal policy was left largely in national hands when the euro was set up. Rather than a design failure, the arguments for the design were both economic and political: countries in a monetary union need to retain an ability to stabilize their economies, as changes in interest rates and in the exchange rates become unavailable; and decision-making on fiscal policy is a key element of national sovereignty and has to respond to different national preferences. But, as a compromise with the need to avoid undermining monetary policy in the euro area by letting public debt rise to unsustainable levels, fiscal rules to constrain strongly deviant national behavior were included in the so-called Stability and Growth Pact (SGP). Pre-agreed rules were seen as work in progress - a suitable mid-way station for an Economic and Monetary Union (EMU) under construction.

The SGP has been modified several times, in part to leave more room for individual adjustment in difficult times, but also to tighten the monitoring of public debt - the main risk to sustainability. But from the start of the financial crisis the sum of national SGP recommendations became difficult to reconcile with the need for fiscal policies to contribute to stabilization. From 2014 the European Central Bank (ECB) has been able to sustain a slow recovery in the euro area and to avoid deflation, while the sum of national fiscal policies has turned from contractionary to broadly neutral. Yet, given the slow recovery, the idea of supplementing the SGP by a “euro area fiscal stance” has been advanced by the Commission.

In its recent report[1] – an independent body of five economists to advise the Commission on fiscal policy – concludes that the euro area economies will by 2018 have come far enough in their recovery to make any net aggregate adjustment to the national recommendations of the SGP unwarranted. But it argues at the same time that, while the high-debt countries need to pursue their consolidation further to put their debt ratios on a clearly declining path, countries that have built up a stronger fiscal performance than they had committed to – primarily Germany and the Netherlands – should use that space to pursue modestly expansionary policies. The report also concludes that a re-composition of government expenditures to raise investment spending, which has borne heavy budgetary consolidations since about 2011, is overdue in most of the euro area countries. It is now insufficiently ambitious to aim only at eliminating slack; more investment would also raise potential growth.

These two recommendations – more expansionary policies in countries with fiscal space and more investment spending – are, in the present decentralized euro area governance framework, subject to voluntary coordination only. They foreshadow issues the euro area would have to deal with, if the desired “deepening”

[1] https://ec.europa.eu/info/publications/assessment-prosepctive-fiscal-stance-apprppriate-euro-area.en

of Economic and Monetary Union is to have content, as outlined in the Report of the Five Presidents of 2015 and restated by the Commission in its Reflection Paper on EMU of May 2017. Furthermore, while the topicality of a euro area fiscal stance may currently have faded, it is bound to return, either in a future crisis or during periods when monetary policy again, despite extraordinary efforts of accommodation from the ECB, finds it difficult to sustain high levels of demand and employment. The time for considering fiscal policy from an area-wide perspective at this point of better performance and in a more dispassionate way, seems propitious now that policy-making in EMU is faced with more "normal" challenges than over the past decade.

Carlos Cuerpo

IMPLICATIONS FOR ECONOMIC POLICIES AND THE INTERNATIONAL INSTITUTIONAL FRAMEWORK OF A REVERSAL IN GLOBALIZATION

Recent geo-political events, together with last minute backlashes in on-going trade agreements have spurred concerns about the nature and extent of a reversal in globalization and potential counteracting policy responses.

Before turning to specific policy actions, an initial diagnosis on the nature and extent of recent globalization trends is in order. First, when looking at trade flows, global trade seems to have reached a plateau since 2015.[1] This pattern has become widespread across products (see Evenett and Fritz, 2016) and appears to be of a structural origin as historical elasticities would imply larger gains associated with current positive economic growth. Results on the specific structural factors negatively affecting trade seem rather inconclusive at this stage (see Ferrantino and Taglioni, 2014), although Global Value Chains or an acceleration in protectionist measures particularly from G20 members are usually cited as potential candidates.[2] Second, financial de-globalization is a reality. Global capital flows have suffered a collapse following the financial crisis, going back mid-90s level. Financial de-globalization is a banking one (see Forbes et al., 2016). There has been a composition effect, with increasing resources absorbed by the official sector, according to BIS consolidated banking statistics. Again, structural factors such as an increased home bias, larger government financial assistance to the banking sector or spillovers coming from domestic regulatory changes (e.g. lending policies).

Structural challenges to globalization call for structural policies. Policy response must be all-encompassing as the task is multi-faceted. It should cover the following areas:

- *Social concerns:* an inclusive wave of globalization is necessary to account for growing social resistance and concerns on the distribution of the benefits of globalization. Increasing the base of the population benefiting from open exchanges could initially be done via partial solutions such as trade adjustment assistance, generalized access to health care or a higher share of multilateral agreements in favour of those with lower negotiating power, amongst others.
- *Global Value Chains:* the optimal location of firms is shaped by asymmetric trading costs on top of traditional competitiveness measures (Antrás and

[1] See the 19th Global Trade Alert Report, based on high frequency world trade monitor data from the Netherlands Bureau for Economic Policy Analysis.

[2] Protectionist measures pattern has shifted from dumping subsidies to financial assistance and back to trade restrictions.

Gortari 2016). These costs do not only depend on exogenous factors such as distance or transportation, they are endogenous to trade policy as a country would benefit from integration with economies that are relatively close in terms of the value chain. Trade policy efforts should therefore focus on deepening links with countries whose firms are operating closely in terms of the value chain (both upstream and downstream). This is particularly relevant within a Monetary Union, where positive externalities arise, as all Members would benefit from highly competitive partners in associated production phases.

- *Education:* changes in trade patterns also call for structural policies oriented towards providing a better matching between workers' skills and firms' necessities. The OECD has recently advocated (see OECD Skills Outlook 2017) for measures fostering on-the-job training or lifelong training, for example.
- *Financial stability:* while banking flows are suffering a set-back, policies should aim at consolidating market-based flows (such as direct investment), less prone to reversal and thus leading to higher financial stability.
- *Institutional Design:* Outdated and rigid institutions have generated wide distrust towards globalization and spurred the rise of populism and anti-immigrant sentiments. In this context, the G20 might be an appropriate forum for a coordinated and decisive response. The current German presidency is advocating in this direction as evidence by its motto: "Shaping an interconnected world".

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