INTEGRATION AND CONVERGENCE IN THE EMU
A COMPLEX DYNAMICS

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The views and opinions expressed in this presentation are those of the author and do not necessarily reflect the official policy or position of Banque de France.
INSTITUTIONAL INTEGRATION: A LOT OF STEPS HAVE BEEN MADE SINCE (AND BECAUSE OF?) THE CRISIS

- **05/2010** Creation of the EFSF
- **11/2010** Establishment of ESRB and ESAs
- **07/2011** Signing of the treaty establishing the ESM
- **12/2011** Six Pack comes into force
- **03/2012** Signing of the TSCG
- **06/2012** Euro area statement on the Banking Union
- **09/2012** Introduction of the OMTs by the ECB
- **05/2013** Two Pack comes into force
- **11/2014** UB Pillar I (SSM)
- **01/2016** UB Pillar II (SRM)

**Institutional measures**

- **09/2008** Bankruptcy of Lehman Brothers
- **11/2010** 1st Greek Programme
- **05/2011** 2nd Greek Programme
- **07/2012** Spanish Programme
- **02/2012** Irish Programme Portuguese Programme
- **03/2013** Cypriot Programme
- **08/2015** 3rd Greek Programme
INSTITUTIONAL INTEGRATION: A LOT OF ADDITIONAL STEPS ARE IN THE PIPE BUT TWO STRONG RED LINES REMAIN

- The Meseberg roadmap:
  - Public backstop to the Single Resolution Fund (SRF)
  - European Deposit Insurance Scheme (EDIS)
  - Eurozone budget to promote competitiveness, convergence and stabilization
  - Unemployment insurance stabilization fund (without permanent transfers)
  - Further progress on Capital Markets Union...

- Current (and strong) red lines:
  - Debt mutualization
  - Permanent public transfers
EU REAL CONVERGENCE: WHERE DO WE STAND NOW?

Level of GDP per capita in 1999 (UE=100; in PPS)

Cumulative change 1999 – 2017 (UE normalised to 0)

Initially better off than average UE

Initially worse off than average UE

Relative gain in GDP per capita

Relative fall in GDP per capita

XX : EA first joiners
XX : other EA members
XX : non-EA EU members

Source: ECB, Banque de France calculations
20 YEARS AHEAD: FURTHER REAL DIVERGENCE?
(GDP PER CAPITA, CONSTANT PRICES – 2010 REFERENCE LEVELS)

Option 1: 1999-2008 Trend (from 2018)

Option 2: 2008-2018 Trend (from 2018)

Source: Ameco, BDF calculations
RISE OF OLD-AGE DEPENDENCY RATIO EVERYWHERE, BUT INCREASING DIVERGENCES (65 AND OVER, % OF TOTAL POPULATION)

Source: Ageing report (2018)
If there is perfect intra EA labour mobility, real divergence becomes **only a problem of territory planning**

In this case, limited additional needs of intra EA transfers
- Transfers for public investment in infrastructures (but no need of change of scale of European Structural and Cohesion Funds)
- Some mutualisation of public education costs at least during the transition period
- But legacy problems (public debt)

And need of structural reforms to facilitate labour mobility
- Cross-border pensions right portability is key
WEAK INTEGRATION OF LABOUR MARKETS

Index of under-employment (unemployed, discouraged, involuntary partial Time, % of labour force)

Labour cost index in manufacturing (2001Q1=100)

Source Eurostat, BDF calculations (unemployed, discouraged, involuntary partial Time, % of labour force)
WEAK INTEGRATION OF LABOUR MARKETS

Youth unemployment rate (% active population)

Source: Ameco

EU-28/EFTA foreign-born population of working age by origin

Source: Eurostat
EDUCATION: HETEROGENEITY OF LEVEL AND SPENDINGS

PISA science

Source: OECD

Education spending (% of GDP)

Source: Ageing report (2018)
Percentage of adults scoring at each proficiency level in literacy and numeracy
If we assume desired imperfect intra EA labour mobility, real divergence is inevitable and could be worsened by labour mobility (« The lessons of Massachusetts for EMU » (P. Krugman, 1993) : « A more integrated market leads to divergence in both the Economic structure and the growth rate of regions. »

Hence, there is a need for risk sharing
- to address idiosyncratic shocks and smooth cyclical divergence
- but also to mitigate structural divergences

Private risk sharing through global financial integration can help, but would it be enough?

« The lessons of Massachusetts for EMU » (P. Krugman) : «In the US the heavily federalized fiscal system offers a partial solution to the problem of regional stabilization. Unless there is a massive change in European institutions, this automatic cushion will be absent.” remain partly true
BUMPY NOMINAL CONVERGENCE AND PAINFUL ADJUSTMENTS

REER (based on ULC, Index, 2008 = 100)

Source: Ameco
BUMPY PATH OF FINANCIAL INTEGRATION IN THE EURO AREA

Sources: ECB and ECB calculations.
REAL DIVERGENCE, HOW MUCH IT MATTERS?

- The trade off between risk sharing and risk reduction: the unpleasant arithmetic due to:
  - divergent public debt level and path
  - GDP growth divergence
  - resilient banks/sovereign nexus and doom loop
  - worsening effect of potential increased labour mobility

Banking Union, Capital Markets Union are decisive (but unachieved) steps forward but we could need more?
EVOLUTION OF PUBLIC DEBT IN THE EURO AREA
(GROSS PUBLIC DEBT, % OF GDP)

Source: Eurostat
EMU IN A GLOBALISED WORLD: A DECREASING COMPARATIVE ADVANTAGE OF A CUSTOMARY UNION

Evolution of import tariffs
(Applied MFN, 3-year moving average)

Emerging economies
Advanced economies

Euro adoption

Emerging = average Brazil, China, India, Russia, Korea; Advanced = average France, United Kingdom, United States, Japan
Source: World Bank
EMU IN A GLOBALISED WORLD: A DECREASING COMPARATIVE ADVANTAGE OF FINANCIAL INTEGRATION

SOURCE: INSTITUTIONAL INVESTORS HOME BIAS IN EUROPE'S CAPITAL MARKET UNION, DARVAS, SCHOENMAKER, WP BRUEGHEL, 2017
Achieve the Single Market, including for financial services

Strengthen the institutional integration

More labour market integration,

Upward education level harmonisation