Ralf Kronberger
Director
Austrian Federal Economic Chamber

Introductory Remarks: Convergence of Production, Investment and the Reduction of Imbalances

Today's topic of our session "Convergence of Production, Investment and the Reduction of Imbalances" made me remember the public discourse about the Economic and Monetary Union in the early 1990s. At this time, the Maastricht Treaty was signed and I was still a student of economics. Back then, the academic debate was about whether the European Union was ready for adopting a single currency or not. The „old" approach to the optimum currency area theory was set against "new approaches". The first one was very much about what to do if there was a disparity in real economic indicators. Alternative means – other than the exchange rate instruments – of adapting to disparities were needed, i.e. mobility of factors, wage flexibility or fiscal transfers. This was seen as the precondition for introducing a single currency. The new approaches suggested that even though economic indicators diverged one could introduce the single currency and thereafter over time convergence could be observed, i.e. business cycles would be more synchronized (Kronberger, 2010). When I first heard about today's topic it occurred to me that not a lot has changed since then. Which of course is not right. Now we know more about the empirics, be it the development of real economic variables or be it the institutional development of the Economic and Monetary Union.

Having a look at the empirics concerning some specific economic variables the following can be said: Franks et al. (2018) find a mixed picture regarding the convergence of GDP per capita. Before 1992 (starting with observations in 1960) 12 euro area countries with lower GDP grew faster than their richer counterparts which already had a higher level of GDP (catching up). The authors call this type of convergence beta convergence according to Sala-i-Martin (1996). After the signing of the Maastricht Treaty the convergence of the GDP slowed and came subsequently to a halt. Countries joining the euro area starting from 2007 showed continued convergence. Comparing the 19 euro area countries to the 28 EU Member States, the convergence of the first has been significantly higher in the period from 1993 to 2015.[1]

The authors also compute the so-called sigma convergence. It gives information whether the dispersion of GDP per capita decreases over time. For the observed countries it shows a similar behavior as does the beta convergence. Of the 12 euro area countries, in particular Greece, Italy, Portugal and Spain showed divergence with regard to per capita income between 1999 and 2014 (ECB, 2015). Although these four countries obtained sizeable capital inflows they consisted mainly of debt instruments and banking flows and much less of foreign direct investment. Therefore, capital inflows did not trigger real convergence as predicted by theory. Reasons can be found in the quality of institutions and governance, structural rigidities even contributing to the reversal

[1] *ECB (2015) shows similar results regarding the two indicators of convergence.*

of convergence and a demand driven credit boom. Productivity growth in Greece, Spain and Portugal lagged behind the average of the euro area. Low productivity in the non-tradable and even in the tradable sector were in the end caused by weaknesses in the business environment resulting in a lack of innovation.

The institutional development of the European Union regarding convergence showed some important steps forward in the period after the economic crisis. Many acts regarding financial regulations have been stipulated in the last couple of years, be it Basel III or be it the (not yet complete) European banking union to just mention the most well-known examples. In 2014 the Investment Plan for Europe, the so-called Juncker Plan, has been launched. Much progress has also be seen in the area of fiscal rules. They have been enhanced and put more effective, for instance, by the so called six pack and the two pack. An interesting by-product of the six pack are the two procedures on Macroeconomic Imbalances (MIP) since they point basically to other economic indicators than the ones related to public finances. They were born out of the conclusion, that fiscal imbalances were tied to imbalances in other economic sectors. So far, this conclusion is straight forward and rather undisputable. It is also undisputable that these two Macroeconomic Imbalances Procedures have not received much public attention und they are kept on rather a "low level" in the policy arena. Until now only in-depth reviews have been applied:[2] "The EIP (Excessive Imbalances Procedure) has so far never been launched, the reason being that the identification of excessive imbalances was followed by strengthened policy commitments in National Reform Programs followed up by implementation." (European Commission, 2016a, 54). Nonetheless, Bricogne and Turrini (2017) find that "MIP-related recommendations have a higher chance of being followed up by implementation."[3] Despite no sanctions were triggered by the MIP the implementation of the respective regulation was a success.

Strength and weakness of the MIP is the room for maneuver with regard to the interpretation of the existence of macroeconomic imbalances. The Commission and the Council are not bound to trigger the procedure when thresholds of relevant economic variables are passed (Kronberger, 2017, 520). Since there is not one agreed definition of a harming macroeconomic imbalance among economists and furthermore a big number of relevant economic models yield to different results it can make sense not to stick "stubbornly" to defined quantitative thresholds. A weakness of the MIP could be that the recommendation of policy measures is based on interpretation: Is the interpretation of the harming macroeconomic imbalance correct? Is the recommended policy measure adequate, in the sense that it helps to improve the imbalance?[4] For instance, the current account balance is used as a relevant indicator for the MIP scoreboard regarding external competitiveness. Using this aggregate measure, however, does not distinguish between the current account balance vis-à-vis the euro area, the European Union and the rest of the world. This makes a lot of a difference for the interpretation of passing thresholds. In the case of Germany, its current account surplus is also fed significantly by economic exchange with the rest of the world (European Commission, 2016b). As such it cannot be concluded that a harmful imbalance within the European Union or the euro area exists, although a critical threshold of the aggregate indicator of the current account is eventually passed.[5]

In this session Marco Buti, Director General for Economic and Financial Affairs at the European Commission, who holds this post since 2008, will give some insights on the development of macroeconomic indicators and therefrom derived conclusions and policy measures.

Wilhelm Molterer, former Vice Chancellor and Minister of Finance in Austria, who is Managing Director of the European Fund for Strategic Investments (EFSI) since 2015, gives an introduction to the EFSI and explains its importance for activating investment within the European Union, thereby helping to increase productivity.

Robert Ottel looks back to a longstanding career within voestalpine. Since 2005 he is member of the board of voestalpine AG as Chief Financial Officer (CFO). He will give us a picture of what drives a multinational steel company when deciding on important investments and what motives are at present when choosing the investment location.

References

Bricogne, J.-C. and Turrini, A. 2017. The EU Macroeconomic Imbalance Procedure: Some impact and no sanctions. VOX CEPR Policy Portal. https://voxeu.org/article/eu-macroeconomic-imbalance-procedure-some-impact-and-no-sanctions

ECB. 2015. Real convergence in the euro area: evidence, theory and policy implications. ECB Economic Bulletin. 5/2015. 30–45.

European Commission. 2016a. The Macroeconomic Imbalance Procedure – Rationale, Process, Application: A Compendium. Institutional Paper 039. European Economy. Luxembourg.

European Commission. 2016b. Country Report Germany 2016 – Including an In-Depth Review on the prevention and correction of macroeconomic imbalances. Commission Staff Working Document 75. Brussels.

European Commission. 2018. In-depth reviews 2018. https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/macroeconomic-imbalance-procedure/mip-surveillance-2018_en#in-depth-reviews-2018

Franks, J. et al. 2018. Economic Convergence in the Euro Area: Coming Together or Drifting Apart? IMF Working Paper WP/18/10. International Monetary Fund. Washington D.C.

Kronberger, R. 2010. Der Euro-Raum im Lichte der Theorie der Optimalen Währungsgebiete. In: Forum Internationale Wirtschaft (Ed.), FIW Kompetenzzentrum Österreichs Außenwirtschaft 2010. Wien.

[2] *For the year 2018 12 in-depth reviews have been carried out: Bulgaria, Croatia, Cyprus, France, Germany, Ireland, Italy, the Netherlands, Portugal, Slovenia, Spain and Sweden (European Commission, 2018).*

[3] *They compare the progress of countries applying country-specific recommendations who follow the MIP with countries not following MIP.*

[4] *For a critical discussion on MIP see for instance Tamborini, (2018). One of his conclusions is that the MIP would be an imperfect replacement for fully federalized fiscal institutions.*

[5] *The European Commission is conscious of this fact (European Commission, 2016b) nonetheless it would make sense to adjust the indicator to what is needed to interpret harmful macroeconomic imbalances within the European Union or the euro are.*

Kronberger, R. 2017. Österreichische Wirtschaftspolitik – eine anwendungsorientierte Einführung. 2. Auflage. Facultas Wien.

Sala-i-Martin, X. 1996. The Classical Approach to Convergence Analysis. In: Economic Journal, 106-437, 1019–1036.

Tamborini, R. 2018. Macroeconomic Imbalances and the Euro Zone. Alternative Views. EconPol Working Paper 14/2018. ifo Institute, Munich.