The Next EU Multiannual Financial Framework –
How to stimulate growth and reduce
development disparities among the EU regions?

“*Black swans* and the EU budget: do they menace its relevance?”

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Contents

1. The world in a glimpse

- A proliferation of *black swans* (tail risks, crises): financial/economic; ecological; demographic,
- *Overstretched* societies: economically; socially; militarily...political strain
- *Strain* in the West
- **The Great Shift: the rise of Asia**
- Economic slowdown (quasi-stagnation?) in industrial societies
- Capacity to deal with shocks: objective limits vs. unpreparedness
- The struggle over limited resources: oil, food, water (Malthus again?)
- A crisis of globalization (over-dependency on external supply chains; inter-connectedness/ Financial markets and systemic risks
- Governance bottlenecks (national; regional (EU); global)
- Limits of openness
- Limits of cognition/ a crisis of risk modeling
- An age of uncertainty, insecurity and **distributional struggle** (volatility, domino effects/contagion; back up systems...costs)

1.1. Effects of the Crisis

- State intervention to rescue financial institutions: lessons of the Great Depression
- Massive costs of bail outs
- A huge debt problem (compounded by aging and effects of climate change)
- Sovereign debt crises (Reinhart and Rogoff)
- Global crowding out effect : impact on interest rates (watch long term rates...)
- Getting out of an era of profligacy in an orderly way...
- Entering an age of diminished expectations and growing uncertainty (insecurity)
- “Failed states” (Iceland) and wrecked economies (Ireland) in developed countries;
- Intensity of contagion effects
- Social strain (the erosion of the middle class)

2. An *overstrained* EU

- Herman van Rompuy: “the EU model is under threat”; is Europe 2020 a proper answer?
- The Crisis, recession, stagnation…jobs
- Rediscovering major cleavages in the EMU(EU)
- The crisis of the EMU (EU): the reform of governance
- “The Monti trade-off”:the single market may ask for intra-Union fiscal transfers
- Lack of burden sharing arrangements in the EU;
- Renationalization of policies?
- Variable geometry on the rise?
- The future of convergence (the case of NMSs)
- Deepening of integration vs. fragmentation: **more vs less Europe** (what does it mean for the EU budget?).

3. Is the planned new framework (2014-2020) appropriate?

- It seems to assume that we will get back to "business as usual" after the crisis is over...
- If this assumption is discarded the new framework looks like a relic, a prisoner of the past...in spite of its pretense (Europe 2020, too); would its structure had been different in 2007/8?
- There is a sort of disconnect between this new framework and what the current crisis tells us...
- If the choice is for **more Europe** as a response to the Crisis, the EU budget should be bigger; the EP is right, philosophically, in this regard...
- De facto, there is an additional budget in the making for the euro-zone (EFSF)
- It does not consider the need for drastic changes in the functioning of the EU institutions and policies
- Its own resources need to be bolstered

3.1. The EU budget and the EU economic governance: a critical view

- It does not secure a fiscal underpinning of the EMU, of the EU; two EU budgets?
- It does not address asymmetric shocks sufficiently (ex: unemployment insurance policies at the EU level)
- The *convergence challenge*
- Little resources assigned to EU level industrial policies; is inter-governmental work the solution?

3.1.1 The convergence challenge

- It is of long vintage (structural and cohesion funds)
- Only very partial success: the “mezzogiornification of the southern fringe”/ fractures in the EMU (EU), which were obscured by the *Great Moderation* period (cheap credit and imports)….*The Great Misperception*
- The competitiveness challenge in the EMU (in the EU);
- Weaknesses of the growth model in NMSs (big external deficits and non-tradable sector overinvestment)
- redesigning growth models in a new world context
- What can EU policies do?
- The role of the EU budget

3.2. The EU budget: a benign view

- It maintains a substantial share for structural and cohesion funds;
- CAP should be protected in view of the looming world food crisis (the rise in the price of basic commodities diminishes the conflict with agriculture-based emerging economies)
- Not much can be done about its size since EU governments turn inward-looking

3.3. EU budget own resources

- For the EU (EMU) to withstand pressure and cope with growing challenges, as a Union, deeper integration is arguably needed: this demands a bigger EU budget (again, the two EU budgets question...)
- Own EU budget resources should be increased
- A *financial transactions tax* is appropriate in my view; it would help tame financial markets in conjunction with other measures

4. The role of EU funds in NMSs

- A *macroeconomic function*; to help limit pro-cyclical policies in a a crisis
- A *developmental function*: infrastructure and rural modernization projects;
- A *structural reform function*: help improve the use of public funds, the reform of public administration
- A *social function*: the job issue (social strain)
- Help reduce EU *economic discrepancies*
- Planning for a *double deep* and mounting crisis in the EMU

4.1. The impact of the Crisis

- It has reduced the level of potential output;
- The income per capita in Romania has gone down from cca 47% to 45% of the EU average (PPS terms) since 2008; euro based the drop was from 26% to 23.4% (Eurostat data)
- It has, quite likely, diminished the potential durable yearly economic growth rate;in the case of Romania, from about 5-5,5% (before the crisis) to about 3-3,5%;
- The computations on economic growth rates are optimistic were Europe to revisit a recessionary period, and, moreover, lapse into a lasting quasi-stagnation (A “Japanized” dynamic...”the lost decade”); what Reinhart and Rogoff, and others, predict for the aftermath of very deep financial crises.
- A double deep recession would heighten the strategic importance of EU funds

4.2. EU funds in Romania (I)

- Very poor absorption ratio until now
- Raising the level of EU budget expenditure: an absorption ratio of above 3% of GDP would increase budget revenues by 2% (cca 1% of Romania's GDP is its contribution to the EU budget); nota bene: Romania has one of the lowest fiscal revenues ratio in the EU, 27- 28% of GDP during 2004-2010, as against an average of 39% in EU-27 and cca 33% in NMSs
- A net rise in budget revenues of 2% of GDP could, ceteris paribus, increase the economic growth rate by 0,6-1%, and bring the durable economic growth rate above 4%; a net rise in budget revenues of 3% could bring the economic growth around 4.5% of GDP.
- A key qualification: the estimates above do not factor in a new recession in Europe and, what would be worse, disorderly defaults in the euro-zone with ensuing lasting bad effects
- Should worst case scenario occur, EU funds could play a significant damage limitation function

4.2. EU funds in Romania (II)

- In the case of deeper euro-zone crisis, of defaults, Romania should be able to use EU funds in order to protect its banking sector (Greek banks hold cca 20% of Romania's banking sector assets)
- Agriculture is a golden activity (a true gold mine) in view of rising world relative food prices; it should be seen as a priority for the EU as a whole;
- The scarcity of capital worldwide puts an additional premium on EU funds;
- The opportunity cost of not absorbing EU funds is enormous: a/EU funds could be reoriented to other users; b/ the economic cost per se; c/ it could backfire by signaling fiscal indiscipline and resulting sanctions

4.3. Catching up (convergence) prospects are dimmer

- By using PPS terms, an annual economic growth rate differential of 3%, as against the EU area, would permit to reach cca 80% of the EU average income level in about 18-20 years time (from the current level of about 45%); on euro based calculations the rise would be from around 23.5% in 2010 to cca 40% n 2030; a median value would give 60-65%.
- the lower the rate differential the longer the convergence period
- These are back of the envelope calculations and based on uncertain premises; but they challenges ahead. But consider the **"Great Shift"** and its impact...
- There is need for more tailor made policies –fitting Romanian circumstances, even if EU rules are constraining (see slide provide a measure of which follows)

4.3.1 Revisiting economic policy in order to foster catching up

- The *Washington Consensus* has been disputed since long
- Questionable IFIs policies (neglect of industrial policies; opening of the capital account, etc)
- Diversity of policy/ instruments (Dani Rodrik)
- **Taming financial markets** is a must for regaining financial stability

5. Final remarks

- *Crisis management* is overriding; the EU budget debate side-lined?
- The EU new financial framework has to be better linked with the existential challenges facing the EU; think about the **Great Shift**
- The impact of the EU governance reform on the EU budget is not clear;
- EU economic governance reform implies more than fiscal rules
- Two EU budgets?
- National budgets (national overall policies) and the EU budget (ex: fiscal indiscipline can lead to sanctions, freeze of EU funds)
- The competitiveness challenge will bite increasingly because of shifting fortunes in the world economy
- Financial markets need to be tamed: for they have turned into an in-built destabilizer for economies: what the Vickers commission and the EC have done is commendable, but more should be done
- The importance of global arrangements (G20, IFIs reform, etc).

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