

Europe at a Crossroads How to Restore Shared Prosperity

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From Multilateralism to Hegemony

- The post WWII Trente Glorieuses: A regulated capitalism for shared prosperity
 - Regulation – industrial policy – investment (public and private)
 - Multilateralism with mutual benefits for the US and the RoW
- 1980s, the end of the old world
 - Great “Moderation” and the end of Redistribution: Inequality
 - The myth of market efficiency: deregulation
 - The US continues to benefit from the system (the Washington Consensus)

The Great “Moderation”: Unregulated capitalism

- Financial liberalization

- Expanded opportunities for risk-taking and rent extraction.
- The 2008 crisis exposed the systemic consequences of private leverage.
- The subsequent adjustment placed a large burden on public finances and households
→ The distribution of risks and adjustment costs is not politically neutral

- The weakening of labour's bargaining power

- Declining union density and collective-bargaining coverage in many advanced economies.
- Globalisation and outsourcing increased the substitutability of labour across borders.
- Labour-market reforms often increased flexibility without equivalent mechanisms to share productivity gains.
- The rise of shareholder-value models strengthened the position of capital relative to labour.

From Hegemony to Competition

- The 2000s: the toy breaks down
 - Polycrisis (from the GFC to geopolitical disruption): the unregulated capitalism turns out to be unstable (surprise!)
 - The rise of China : free trade as a threat
- The US does not win anymore and starts to opt out
 - Common thread of all administrations since 2000
 - Trump accelerates the tendence that was already there

2026: Europe at a Crossroads

- The geopolitical challenge
 - The end of multilateralism. Competition with "friends" and foes (not a Trump phenomenon)
 - China and the BRICs
 - Military expenditure
 - Dependency (energy, military, etc.) as vulnerability
- The Structural Transformation
 - Ecological and digital transitions
 - Inequality and social capital deterioration
- These challenges are grafted onto a structural problem of the European economy

The European choice: let markets do the job

- Draghi and Letta Reports: Enable markets
 - Single Market
 - Capital market union
 - (De)regulation – 28° regime
 - ~~Massive investment needs~~
- Competitiveness compact: leverage the markets
 - Exports-led-growth
 - “The Draghi Report without the money” (cit.)
- The reform of the SGP and the obsession with debt reduction

Thirty years of the same paradigm

- This is not new: The paradigm that shaped Europe is The “New Consensus” centered on market efficiency
 - Maastricht institutions (ECB mandate, SGP, emphasis on competition) tie the hand of governments and expel industrial policy from the toolbox of policy makers
 - The management of the sovereign debt crisis was based on the (wrong) assumption of fiscal profligacy: private debt disappeared from the picture
 - During secular stagnation (2014-2019) monetary policy was left alone trying to fight deflationary pressures in spite of the ZLB
 - After the Covid parenthesis inflation was considered “always and everywhere a monetary phenomenon”
 - Then, the emphasis on public debt reduction, the disappointing reform of the SGP, austerity as the keyword

The World does not Wait

- After 2008 the New Consensus was challenged in many of its prescriptions:
 - Role of fiscal policy, capital controls, crowding in of public investment, multipliers, financial markets' regulation
- Specifically, the “new” notion of industrial policy: much more than competition policy or European Champions
- **Multidimensional policy:** taxes/incentives, regulation, trade and competition policies, monetary policy, finance, regional policies, investment
- Mazzucato's **Entrepreneurial State** that accompanies and, more importantly, shapes markets
- Examples:
 - Incentives to facilitate entry into high value-added sectors
 - Selective and temporary protection
 - Attention to bottlenecks and stable demand flows (demand pull)
 - (fiscal policy) certainty for private investment
- Back to the 1960s?

Out of touch with the real world?

- Why does Europe desperately stick to the old world?
 - Unfit for the Job? The good faith argument
 - EU elites are aging and were educated in the old world.
 - The isolation of German economists, many of which still refer to the Eucken tradition
 - The indictment: **Political capture**
 - The management of the Greek debt crisis and the opposition to restructuring (advocated among others by the IMF): *Cui prodest?*
 - Europe is literally on fire, while almost no action (and no resources) is allocated to mitigation and adaptation. On the other hand, 180bn were quickly found for SAFE and defense expenditure. *Cui prodest?*
 - Energy inflation and (lack of) price controls or windfall profit taxes. *Cui prodest?*
 - (Lack of) regulation of AI and unchecked rise of tech oligarchs. *Cui prodest?*

Power and Progress

- Acemoglu and Johnson: Markets do not self-regulate, and rents appear during the process of innovation
- A problem of *choice*: where do we direct innovation?
- There is never a single path to innovation and investment: Will we use AI to increase surveillance and automation, or to create new tasks and empower workers?
- For most of the 20th century a virtuous mix of innovation and regulation allowed to automate traditional work alongside with the creation of new tasks
- In the closing decades the balance was lost (as a result of political choice). Innovation continued but not the creation of new tasks
 - Higher inequality (in particular for blue collars/low skilled jobs)
 - Concentration of power (political, not just economic)

Что делать?

Choosing to restore Shared Prosperity

- Fully fledged industrial policy for the structural transformation.
 - Massive public investment
- Reverse the inequality trend and protect the middle class
 - Wages/profits
 - High/low wages
 - Income protection through social protection and the welfare state
- Regulation of strategic sectors (finance, tech)
- Cherchez l'argent: Restore the capacity of the State to raise revenue
 - Rebalance taxation: Tax the rich
 - International cooperation on taxing multinationals (BEPS 2.0)

