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Panel Discussion: Brexit and disintegrative tendencies affecting the EU

Annamaria Simonazzi

Sapienza University of Rome and Fondazione G. Brodolini

Outline

- ❖ Before the storm: The German growth model

- ❖ In the storm

  The asymmetric effects of the war

  Industrial restructuring: green and digital transitions

  Risks of further divergence

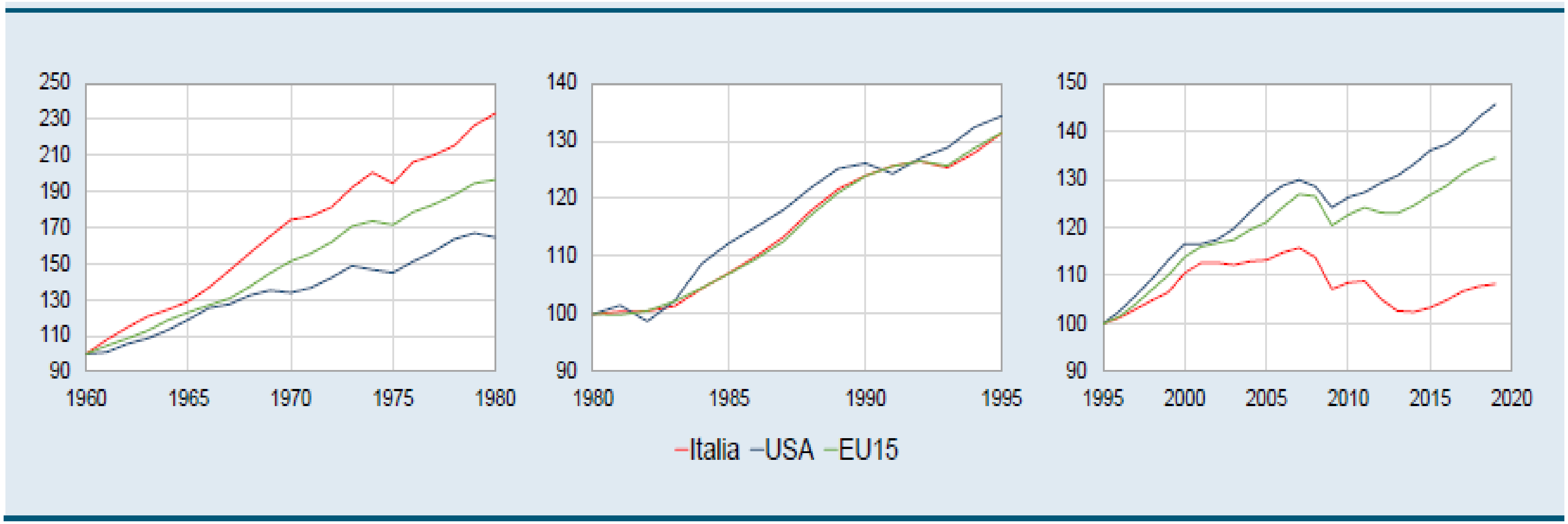
- ❖ Implications for the EU policy

- ❖ The EU in a changing geopolitical context

Before the storm.
The German growth model

- The process of European integration: a process of divergence within the Eurozone which took place within a disappointing growth performance of the monetary union as a whole.

GDP per capita: Italy, EU15 and US, 1960-2019



Two shocks (and post 2008 austerity)

Two shocks

- China: market (Germany) and competitor (Southern periphery)
- East-ward enlargement. Redirection of German FDI and trade to Eastern countries (Wage differentials, exchange rates, cultural and historical ties)

Emergence of the Central European manufacturing network.

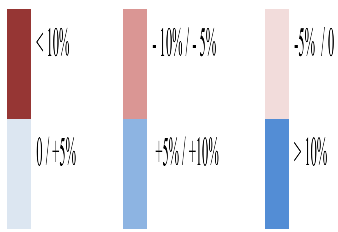
Two peripheries: South and East Europe

Interdependence:

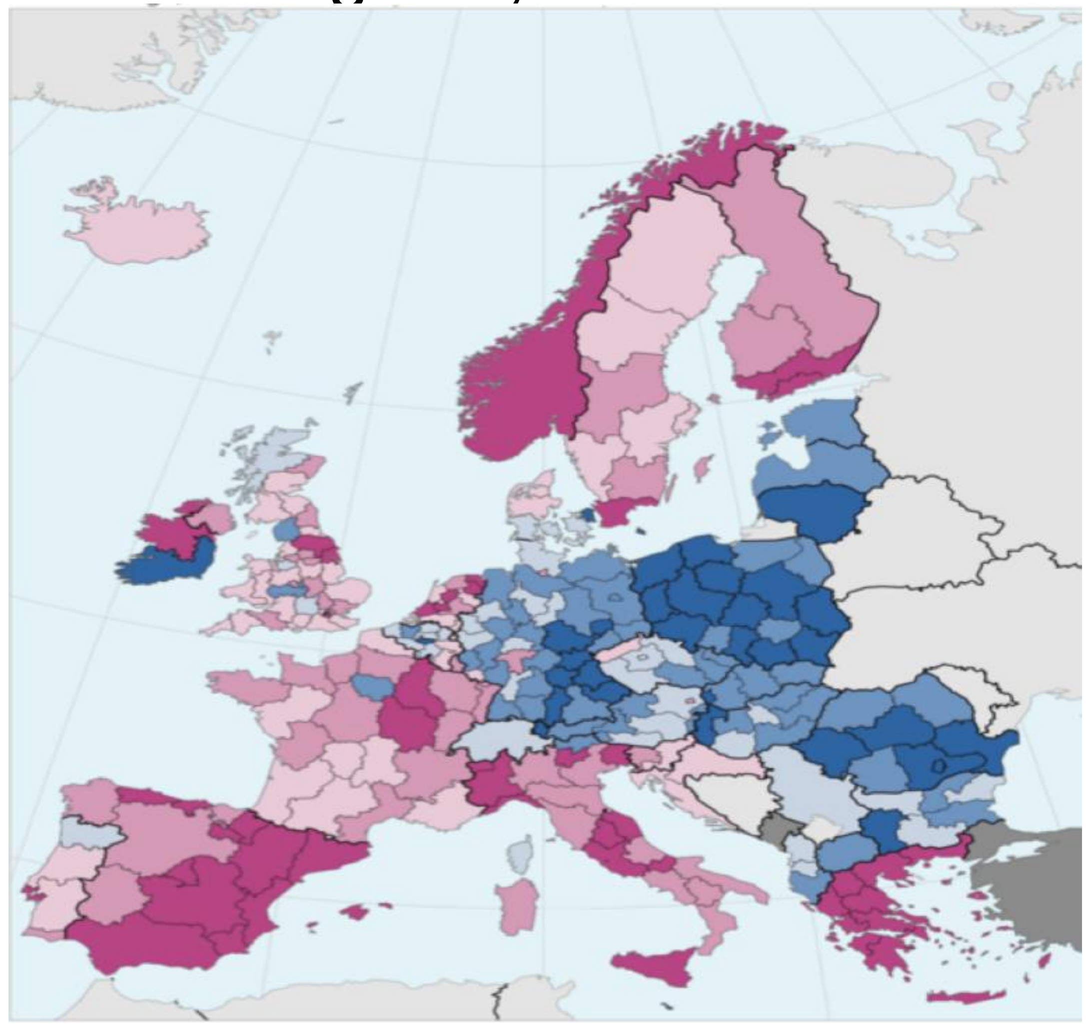
- The core is dependent for its growth on the pattern of specialisation within the EU: the Southern markets providing an outlet for its increasing surplus of manufactures, the Eastern countries supplying cheap inputs for its industries.

This combination of structural divergence and economic interdependence lies behind the fragility of the Union as well as of the improbability of its disintegration given the high costs it would entail for core and peripheries alike.

Change of gross domestic product(GDP) per inhabitant, by NUTS2 regions, 2007-2016



Rates of growth decreasing from blue (positive) to red (negative)



In the storm: New asymmetries?

European countries are affected differently by the Ukraine war, but in ways that transcend the traditional core-periphery division. The German Manufacturing Core (made up of Germany and the Visegrad countries) and Italy, in the southern periphery, are the most affected.

Impact varies with:

- The energy dependence from Russian fuel
- the degree of economic and financial integration with the Russian economy
- the structure of the economy and the weight of energy intensive sectors

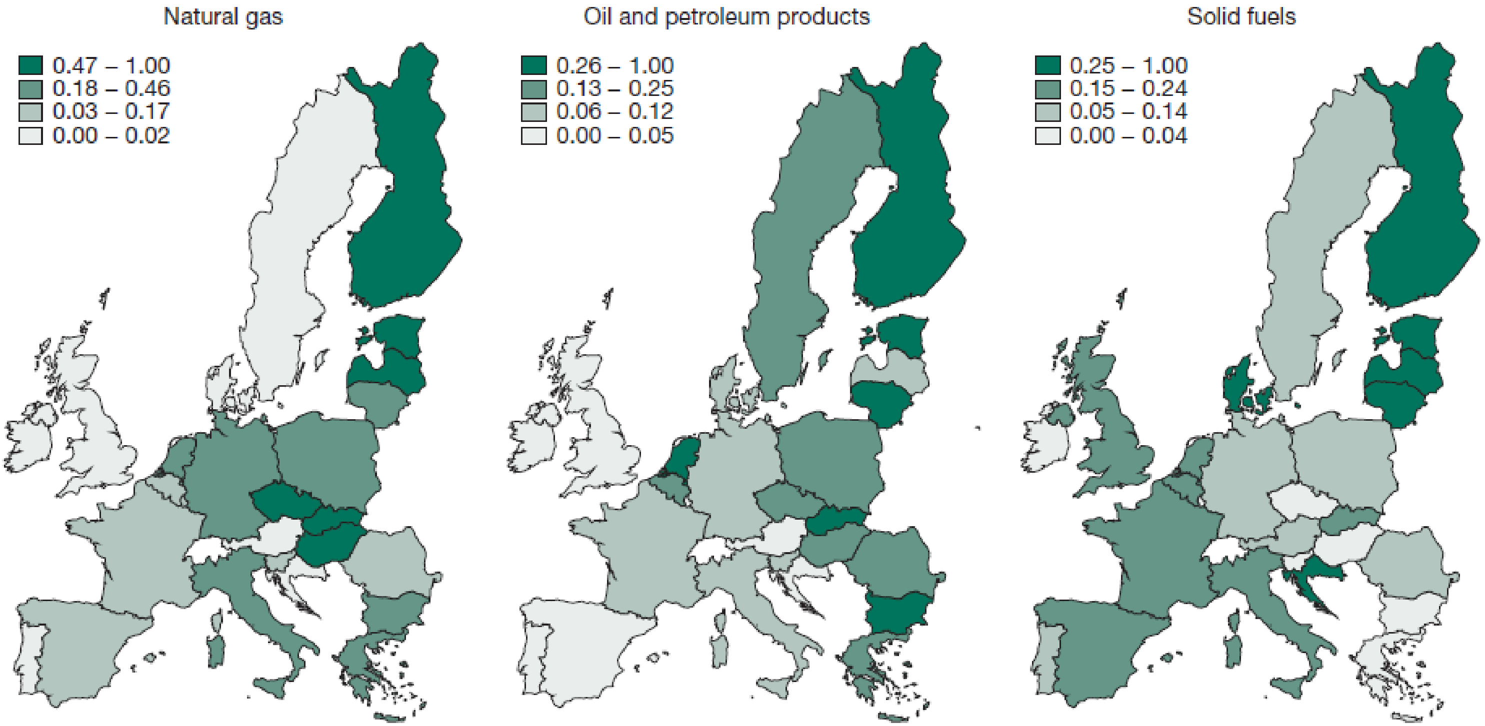
Not only fuels

- dependence on Russian and Ukrainian key raw materials and intermediate goods (e.g. iron, cereals, fertilisers, metals and rare earth).

sector-specific inflationary shocks are transmitted to the whole economy

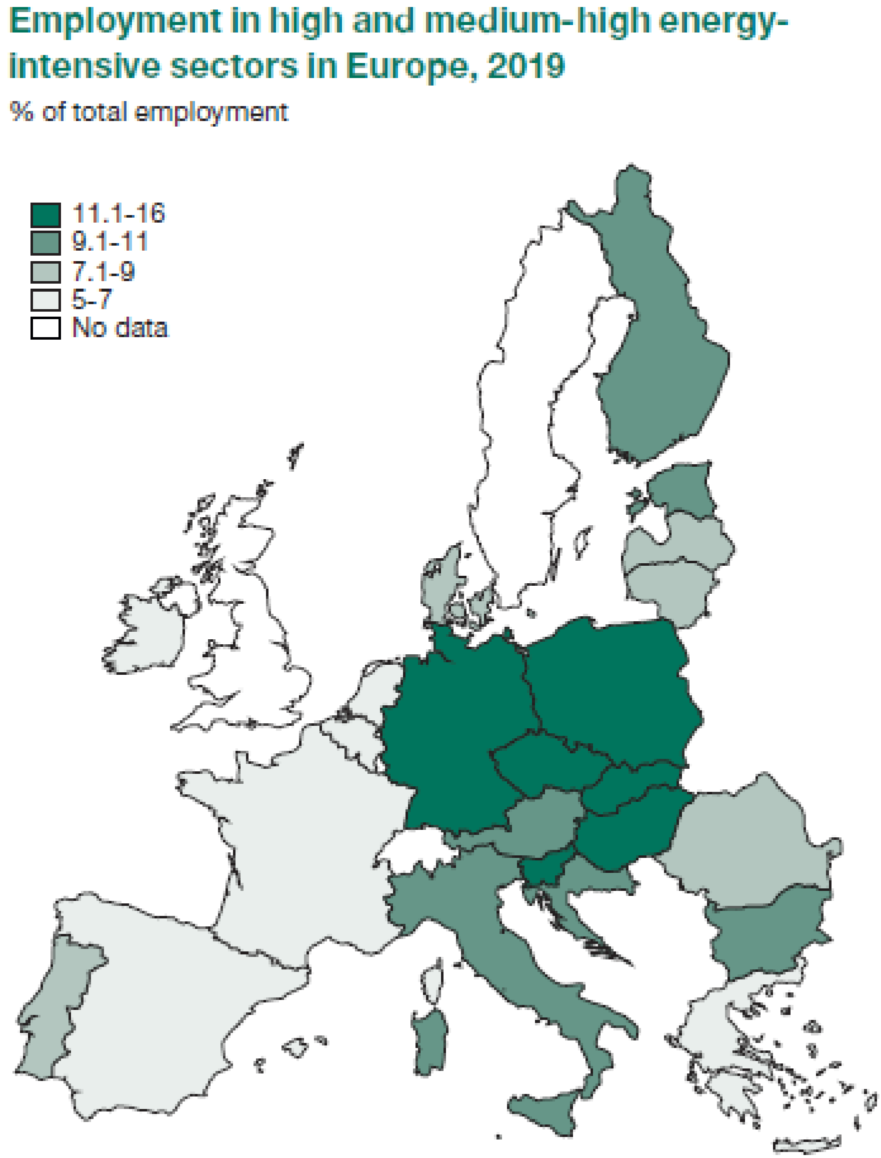
EU member states' dependency on energy imports from Russia, 2019

Index



Celi,Guarascio, Reljic, Simonazzi and Zezza, The Asymmetric Impact of War: Resilience, Vulnerability and Implications for EU Policy, Intereconomics, 2022

The share of energy intensive industries



Old asymmetries?

While the direct impact passes through lines other than Core-periphery (Germany and Italy equally hit), the indirect impact risks reviving the old division:

- Resilience to secondary effects deriving from the EU policy response to stagflation: ECB monetary policy, different fiscal capacity, level of public debt

- Different costs of the restructuring

- Different economic and fiscal capacity to assuage the costs of sanctions and industrial restructuring for households and business

Resilience to the costs of sanctions

- Inflation and recession: if high energy prices persist, pursuing a low level of inflation would require curbing the growth of non-energy prices, which in turn could mean a severe recession. Higher interest rates and falling GDP will increase the debt to GDP ratio.
- Reduction in households' purchasing power, concern for future energy costs and uncertainty about the future lead to a reduction in consumption, contributing to the recession. Policies to contain the energy costs to households and business will entail higher taxes or increasing debts;
- higher public debts collide with a less permissive monetary policy (end of QE) and fiscal rules that have been only suspended, creating well-known credibility problems for the most indebted countries (spreads for Italian bonds have already widen, despite the TPI (Transmission Protection Instrument)

Industrial restructuring

EU fell behind in the race for digital (US) and green (China) technologies

Structural change in the EU economies is no longer postponable

- Disruptions and opportunities will not be evenly distributed across sectors and regions.
- turning the existing “brown firms” into “green firms” will call for “deep” restructuring of industrial ecosystem, demanding coordinated changes within firms and across value chains.

Risks of energy transition: from dependence on Russia for fuel to dependence on China for rare earth and other inputs for renewables

Chinese leadership in production and export of renewables and control of raw materials sources in Africa, Asia and LA

China: from strategic partner to systemic competitor.

European peripheries falling behind?

These changes risk to worsen the gap between core and periphery (and between EU and foreign competitors)

- New technologies require a closely connected, technologically advanced network, often missing in late-comer countries and regions. Agglomeration of industrial activity and the cumulative nature of technological advances can give rise to virtuous and vicious circles that can deepen persistent disparities across European regions

- are based on systems integration that operates at both the technological and the organizational levels. The traditional industrial policy, based on granting subsidies, tax breaks or credit facilities, is not up to the task any longer. Regional and national systems once thriving on incremental innovation can be put to the test.

- Privatisation of knowledge. The omnipresence of digital technologies in industry and services offers Big Tech companies enormous power of penetration, control and profit over the rest of the economy.

Time for new EU institutions and policies?

- Crises are times when old relationships crumble and new ones have to be constructed
- Can the spectre of EU disintegration in a changed international setting push for the reform of the European governance in a more supportive (cohesive) direction?

The response will call for

- A new industrial policy
- A macroeconomic policy agenda for economic and social sustainability
- coordination – by governments, firms, and labour – on a European scale.

A “European” competition and industrial policy?

- An industrial policy at the European level, capable of **anticipating** economic change, directing innovation and its diffusion towards sustainable prosperity
- Coordinate the initiatives within a common vision: reconstruct the relationships between economic subjects, the system of research and the productive world, local and central administrations, the financial system and small businesses, improving those connections that are now essential to the development of new activities, especially those with a high knowledge content
- rebuild state capacity for the successful implementation of this strategic industrial policy approach.
- Close the gap between its member states: Industrial/innovation policy has to embrace cohesion/convergence issues (‘appropriate industrial policy’)

A macroeconomic agenda for sustainability

- the EU's monetary and fiscal authorities must coordinate and calibrate the instruments they use in responding to the crisis.
- a new contingent facility to finance the emergency spending. Eurobonds and financing by BEI could complement national resources.
- a commitment by the ECB to provide liquidity to the market and avoid financial fragmentation (also applying flexibility in the geographical distribution of asset purchases).
- Agree on a sustainable policy to deal with public debts.

For the survival of the Union, the definition of the governance (fiscal rules for the future) is as important as the policy mix (fiscal, monetary and industrial policies) implemented in the current environment.

Italy: up to the task?

There are risks connected with the next elections

The prospects for a serious redesign of long-term industrial policies and the definition of a development agenda worthy of the name appear weak in the current political context

The Recovery Plan (NRRP):

- more demand activation tool than intervention aiming to structurally influence supply capacities.
- Public demand interventions (especially infrastructures) prevalent
- few measures targeted at influencing the development of the Italian production structure of advanced goods and services. Intervention of a horizontal nature, delegated to incentives, and devoid of any conditionality, contributes little to an expansion of the spectrum of our manufacturing capabilities

The EU in a changing geopolitical context

Are necessary reforms likely to be implemented?

- The war marks an “epochal turning point” (Zeitenwende, in Sholtz’s words) for the global geopolitical order. Globalization, already affected by the US-China trade conflict and the disruption following the pandemic, could be in retreat, and we may see the formation of international economic blocs.
- Germany's export-led model was linked to Russian resources and Chinese markets; its political and financial links, however, are with the Atlantic alliance.
- The German ambivalence is matched by American conflicting aims: the US needs a strong Germany to lead a united European front, but not too strong to jeopardize its foreign policy, especially with China

A German U-turn?

It is doubtful that Germany is willing to permanently subordinate its industry, its technology, its trade to Washington, even in the name of moral principles.

However, Germany cannot go alone in the international arena, but

- it can go together with the other member countries, that is, taking care of the development of the whole European area, or
- as the leader of a (weakened) economic empire. Past experience demonstrated the short-sightedness of the latter option.

If the engine of growth falters, distributional conflicts within and between societies intensify, fuelling a global trend towards “populism” and protectionism.

In such a world, there can no longer be any world champions in exporting. Germany and its fellows will have to rethink their export-oriented economic model.

Changed international circumstances could favour the long-desired reforms of European governance