1. Cost competitiveness: A dangerous obsession
Konstantins Benkovskis, Julia Woerz

2. What is a ‘responsible’ fiscal policy today for Europe?
Marco Buti, Nicolas Carnot

3. Why did the price of oil fall after June 2014?
Lutz Kilian

4. Distrust in finance lingers: Jewish persecution and investments
Francesco D’Acunto, Marcel Prokopczuk, Michael Weber

5. Fiscal multipliers in downturns and the effects of Eurozone consolidation
Sebastian Gechert, Andrew Hughes Hallett, Ansgar Rannenberg

6. Ignore at your peril: Liquidity risk and macroprudential policy
Daniel C Hardy, Philip Hochreiter

7. Credit supply and the housing boom
Alejandro Justiniano, Giorgio Primiceri, Andrea Tambalotti

8. The Power of a European Energy Union
Eamon Ryan

9. Steady on the Renminbi
Stephen S. Roach

10. Why is Monetary Policy Underrated?
Koichi Hamada

11. The Economic Consequences of Greece
Alberto Bagnai, Brigitte Granville, Peter Oppenheimer, Antoni Soy

12. A Five-Step Plan for European Prosperity
Michael J. Boskin

13. The Visible Hand of Economic Prosperity
Jürgen Jeske

14. The Price Paradox
Robert Skidelsky

15. Obama Steps Up
Simon Johnson

16. Europe’s Chimerical Capital-Markets Union
Howard Davies

17. Emerging Economies’ Demographic Challenge
Martin Neil Baily, Jaana Remes

18. Making Do With More
J. Bradford DeLong
Cost competitiveness: A dangerous obsession

Konstantins Benkovskis, Julia Woerz

How can we reconcile real effective exchange rate (REER) appreciation – and hence an apparent deterioration in cost competitiveness – with rising world market shares – a clear sign of improved competitiveness? Catching-up in terms of prices while increasingly being able to sell goods and services at the world market has been observed for many emerging economies that are considered as being the most competitive nations worldwide. In contrast, other countries – and among them often peripheral EU members – have sometimes greatly improved their cost competitiveness, yet without a manifestation of increased competitiveness in the form of increased global market shares. So, maybe the focus on cost competitiveness prevalent in the European discussion on how to reduce external imbalances is delusive? Clearly, a nation’s competitiveness is to be assessed on a much broader range of indicators than unit labour costs and real effective exchange rates. Composite indicators such as the World Economic Forum (WEF) or the International Institute for Management Development (IMD) competitiveness rankings take account of a wide range of underlying factors. However, they cannot be replicated or updated in between publication dates.

http://www.voxeu.org/article/cost-competitiveness-obsession

What is a ‘responsible’ fiscal policy today for Europe?

Marco Buti, Nicolas Carnot

There is much debate today on the direction that fiscal policy should take in Europe. On one hand, stocks of public debt are higher than ever, calling for long-run fiscal adjustment. On the other, doubts about the subdued recovery push for slowing fiscal consolidation and providing short-term stimulus. There doesn’t exist a clear compass to balance these considerations. And the balance of course may differ with specific country situations. The European Commission has adopted ‘fiscal responsibility’ as a key pillar of its growth strategy, together with boosting investment and a renewed commitment to structural reforms (European Commission 2014a). Fiscal responsibility has to do with appropriately confronting the current dilemmas, since the Commission at the same time stresses that Member States “still need to secure long term control over deficit and debt levels” while underscoring that consolidation should be “growth-friendly”. The Commission has also judged that concerning the euro area as a whole, a broadly neutral stance emerges from the analysis of country budgetary plans for 2015 (European Commission 2014b). Moreover, while this is deemed to strike an appropriate balance for the overall zone, the country distribution of fiscal policies is judged to be sub-optimal, as “some Member States are called to increase their efforts to comply with the SGP …

http://www.voxeu.org/article/defining-responsible-fiscal-policy-europe
Why did the price of oil fall after June 2014?

Lutz Kilian

After a period of relative stability, the Brent price of crude oil – commonly considered a proxy for the global price of oil – recently experienced a sustained decline that rivalled some of the most dramatic oil price declines to date. Figure 1 shows that the cumulative decline between June and December 2014 alone was 44% (or $49), and the slide of the oil price has continued into January 2015. This price drop has put severe economic stress on oil producers around the world and has called into question the sustainability of alternative forms of energy production. There is growing concern that further steep declines in the price of oil may threaten the economic and political stability of oil-producing countries, but there is also hope that lower oil prices would add much needed strength to the global economy. Many policymakers have been pondering the question of what caused this sudden decline, the severity of which surprised even industry experts, and whether the decline is likely to continue (see, e.g., Arezki and Blanchard 2015).

Although sustained declines in the price of oil have occurred before, notably in 1986 and in late 2008, a natural question is whether this oil price decline is different and, if so, how. Some observers have conjectured that factors specific to the oil market played an important role in causing the price of oil to fall. For example, Arezki and Blanchard (2015) suggest an important contribution of positive oil supply shocks after June 2014, highlighting the examples of Libya, Iraq, and the US.

Distrust in finance lingers: Jewish persecution and investments

Francesco D’Acunto, Marcel Prokopczuk, Michael Weber

Research has shown that discrimination based on race, religion, or gender negatively affects the economic wealth of those discriminated against in areas such as the labour market (Bertrand and Mullainathan 2004) and mortgage lending (Ladd 1998). These forms of discrimination may also reduce the wealth of discriminators, who settle for worse employees or borrower matches. An open issue is to understand the channels through which cultural discriminatory beliefs affect wealth. These channels have important policy implications – they may justify anti-discrimination policies and affirmative actions as a way to increase societal wealth, instead of only fostering the human rights of those discriminated against. Several countries and cultures do not support individual human rights, whereas maximising societal wealth is a widely accepted aim. In a recent paper (D’Acunto et al. 2014), we address this question in the domain of households’ investments, which determine the amount of wealth accumulated over time. We test whether discrimination has long-run negative effects on the wealth of households even after the discriminated population has mostly disappeared.

http://www.voxeu.org/article/causes-2014-oil-price-decline

Fiscal multipliers in downturns and the effects of Eurozone consolidation

Sebastian Gechert, Andrew Hughes Hallett, Ansgar Rannenberg

The literature on the effect of fiscal shocks on macroeconomic performance has expanded a great deal since the outbreak of the Global Crisis. It is driven by new contributions that either question whether fiscal impulses are effective at all during economic downturns (Cogan et al. 2010), or ask whether their effectiveness increases in downturns relative to ‘normal’ circumstances (Auerbach and Gorodnichenko 2012). On our count, the number of contributions that estimate the effectiveness of fiscal policy increased from 56 in 2008 to 149 in 2013. A survey of this literature on how fiscal multipliers depend on the state of the economy and vary across different fiscal instruments would be of special value to policymakers, as it would help to evaluate the impact of fiscal austerity measures in the Eurozone on GDP, for example. However, the literature’s magnitude, and the fact that fiscal multiplier estimates can vary widely from one study to another, render a conventional survey a challenging task with a high probability of inconclusive – and hence unsatisfactory – results. In a new CEPR Policy Insight (Gechert et al. 2015), we therefore report on a meta-regression analysis of fiscal multipliers collected from a broad set of empirical reduced form models conducted by Gechert and Rannenberg (2014).

http://www.voxeu.org/article/fiscal-multipliers-and-eurozone-consolidation

Ignore at your peril: Liquidity risk and macroprudential policy

Daniel C Hardy, Philip Hochreiter

Severe disruption to funding and a liquidity crunch are central features of almost all systemic banking crises. A major fire can break out when a small spark lands on combustible material – so long as there is oxygen available. Likewise, a financial crisis often starts with some relatively minor disturbance to an already-vulnerable system, which is propagated and amplified by liquidity strains. The initial shock that triggered the global financial crisis starting in 2007 – namely, direct losses due to household defaults on U.S. subprime mortgages totaling around US$500 billion – was not overwhelming compared to the aggregate loss absorbing capacity of the U.S., let alone the global financial system; but it was amplified enormously through liquidity effects. Once Lehman Brothers had to start scrambling to meet demands for immediate payment, additional losses were incurred that pushed it deeper into insolvency. And when the commercial banks came under strong funding pressures, national authorities (specifically central banks) felt obliged to inject emergency liquidity, often deviating from the pursuit of traditional monetary policy objectives, and taking on credit risk in the process. Given these facts, how to address systemic liquidity risk should be central to the regulatory and supervisory reform efforts that followed the crisis.

Credit supply and the housing boom

Alejandro Justiniano, Giorgio Primiceri, Andrea Tambalotti

The Global Crisis precipitated the worst US recession since the Great Depression. The spectacular rise in house prices and household debt during the first half of the 2000s, which is illustrated in Figures 1 and 2, was a crucial factor behind these events. Yet, economists disagree on the fundamental causes of this credit and housing boom. The most common narrative in the macroeconomic literature attributes the surge in debt and house prices to a progressive loosening of collateral requirements for mortgage borrowers, such as those brought about by the diffusion of mortgages with higher initial loan-to-value (LTV) ratios, of multiple mortgages on the same property, and of home equity lines of credit. Several recent papers use quantitative general equilibrium models to explore the implications of these less stringent collateral requirements for house prices and other macroeconomic outcomes (e.g. Favilukis et al. 2013, Bianchi et al. 2012, Boz and Mendoza 2014, Garriga et al. 2012). In all of these models, a collateral constraint limits households' ability to borrow to a fraction of the value of their real estate. When this maximum loan-to-value ratio is relaxed, households can increase their leverage and borrow more. As a result, the demand for both credit and housing increases, boosting home prices.

http://www.voxeu.org/article/credit-supply-and-housing-boom

The Power of a European Energy Union

Eamon Ryan

One of the top priorities established by European Commission President Jean-Claude Juncker ahead of his election last summer was the creation of a European energy union. He was right to do so. Done properly, a more cohesive energy policy could achieve three strategic objectives simultaneously. By coordinating research and investment, encouraging conservation, and integrating energy markets, an energy union would help fight climate change, provide Europe with a much needed economic stimulus, and protect the continent from supply shocks, such as those caused by the crises in North Africa and Ukraine. Of course, the European Union’s ability to act is dependent on the willingness of its member states; and, though some of the continent’s leaders have championed the initiative, others have proved less enthusiastic. A crucial test of their collective resolve will be whether they are willing to support key infrastructure projects that deliver on all three objectives. One good example of such a project is the North Sea Countries' Offshore Grid Initiative, a proposal that would link offshore wind farms to a new regional grid, and allow countries to balance variable power supplies across borders. The idea – first advanced in a 2009 memorandum of understanding signed by nine EU member states and Norway – has enormous potential; by 2030, North Sea winds could provide Europe with 10% of its electricity – carbon-free.

Steady on the Renminbi

Stephen S. Roach

Currency wars are raging worldwide, and China is bearing the brunt of them. The renminbi has appreciated sharply over the past several years, exports are sagging, and the risk of deflation is growing. Under these circumstances, many suggest that a reversal in Chinese currency policy to weaken the renminbi is the most logical course. That would be a serious mistake. In fact, as China pursues structural reforms aimed at ensuring its continued development, forced depreciation is about the last thing it needs. It would also be highly problematic for the global economy.

On the surface, the situation certainly appears worrisome – especially when viewed through the currency lens, which captures shifts in Chinese prices relative to those in the rest of the world. According to the Bank for International Settlements (BIS), China’s real effective exchange rate – an inflation-adjusted trade-weighted average of the renminbi’s value relative to the currencies of a cross-section of China’s trading partners – has increased by 26% over the last four years. China’s currency has appreciated more than any of the other 60 countries that the BIS covers (apart from dysfunctional Venezuela, where the figures are distorted by multiple foreign-exchange regimes). By comparison, the allegedly strong US dollar is up just 12% in real terms over the same period.

http://www.project-syndicate.org/commentary/renminbi-exchange-rate-by-stephen-s-roach-2015-02

Why is Monetary Policy Underrated?

Koichi Hamada

Last month – just a few days before the European Central Bank announced its intention to initiate quantitative easing (QE) – I attended a seminar in Geneva with international journalists, policymakers, and investors. The discussions there, much like those in Japan before Prime Minister Shinzo Abe launched his groundbreaking economic-reform strategy in 2012, reflected an inadequate understanding of unconventional monetary policy’s transformative potential.

Indeed, at the seminar, European economists and journalists – especially the Germans, and even some of the Britons in the room – adopted a dismissive tone. “Monetary policy’s power is limited, particularly when the interest rate is so low,” some said. “We cannot count on accommodative monetary policy to spur a portfolio reshuffling,” others added. These statements were all too familiar – and somewhat surprising, given the progress that Japan’s ongoing QE-based strategy has enabled the country to make. Clearly, many in Europe lack an understanding of the history and significance of so-called “Abenomics”; but such an understanding should inform their monetary-policy debates.

The Economic Consequences of Greece

Alberto Bagnai, Brigitte Granville, Peter Oppenheimer, Antoni Soy

The first sentence of the 1957 Treaty of Rome – the founding document of what would eventually become the European Union – calls for “an ever-closer union among the peoples of Europe.” Recently, however, that ideal has come under threat, undermined by its own political elite, which adopted a common currency while entirely neglecting the underlying fault lines. Today, those cracks have been exposed – and widened – by the seemingly never-ending Greek crisis. And nowhere are they more evident than in Greece’s relationship with the International Monetary Fund. When the euro crisis erupted in 2010, European officials realized that they lacked the necessary expertise to manage the threat of sovereign defaults and the potential breakup of the monetary union. For EU officials, avoiding the eurozone’s collapse became the top political imperative, so they turned to the IMF for help. The irregularities in the Fund’s resulting intervention attest to how serious the eurozone’s problems were – and continue to be. For starters, the IMF’s Articles of Agreement require it to interact only with entities that are fully accountable for the help received: a member country’s “treasury, central bank, stabilization fund, or other similar fiscal agency.


A Five-Step Plan for European Prosperity

Michael J. Boskin

Though the Greek crisis has been placed on pause, the economic situation in Europe remains bleak. Eurozone growth is up slightly from its near-recession levels of a few months ago, but projections by the International Monetary Fund for 2015 and 2016 barely exceed 1%. Unemployment remains above 11% – and twice that among the young (and doubled again in countries like Greece and Spain). Greece’s exit from the eurozone would likely be less disruptive now than it would have been a few years ago. The countries most at risk of contagion – Portugal, Spain, and Italy – are less vulnerable now in the eyes of the markets; the European Union has established a bailout fund; and the European Central Bank has launched a large bond-buying program. The real challenge in Europe is continued stagnation and rising public-sector fiscal pressures in bloated welfare states with rapidly aging populations. Restoring growth, opportunity, prosperity, and financial stability will require bold solutions to five inter-related problems. The first problem is fiscal. The math is simple. The tax rate necessary to fund social spending must equal the ratio of the number of people receiving benefits to the number of taxpayers (the dependency ratio), multiplied by the average benefit relative to the income being taxed (the replacement rate).

http://www.project-syndicate.org/commentary/europe-prosperity-obstacles-by-michael-boskin-2015-02

... The EU would be wise to follow suit, by unraveling the currency union and providing debt reduction for its most distressed economies. Only then can the EU’s founding ideals be realized ...

... The possibility of a brighter economic future should be a prize large enough to evoke the same type of leadership through which Europe rose from the ashes of World War II ...
The Visible Hand of Economic Prosperity

Jürgen Jeske

Germany has weathered the financial crisis much better than most of its neighbors. Regarded as the sick man of Europe as recently as 1999, today the country boasts the continent's strongest economy, accounting for roughly a quarter of its exports. Its unemployment rate, at just below 5%, is half the European average. The federal budget is balanced for the first time in a decade. But it would be a mistake to assume that Germany's economic performance vindicates its policymaking. In fact, Germany's current economic dominance has been built on a policy framework that stands in direct opposition to that championed by former Chancellor Ludwig Erhard, the father of its post-World War II "economic miracle." In lieu of Erhard's so-called ordoliberalism – in which the state lays the groundwork for a functioning market economy by actively managing the legal environment – the economic strategy pursued by Chancellor Angela Merkel's government has been haphazard, driven more by political expediency than by any underlying philosophy. Germany would be wise not to take its economic success for granted. In a time of increasing economic and political uncertainty, Erhard's guiding principles are more important than ever.


The Price Paradox

Robert Skidelsky

In 1923, John Maynard Keynes addressed a fundamental economic question that remains valid today. "[I]nflation is unjust and deflation is inexpedient," he wrote. "Of the two perhaps deflation is...the worse; because it is worse...to provoke unemployment than to disappoint the rentier. But it is not necessary that we should weigh one evil against the other." The logic of the argument seems irrefutable. Because many contracts are "sticky" (that is, not easily revised) in monetary terms, inflation and deflation would both inflict damage on the economy. Rising prices reduce the value of savings and pensions, while falling prices reduce profit expectations, encourage hoarding, and increase the real burden of debt. Keynes's dictum has become the ruling wisdom of monetary policy (one of his few to survive). Governments, according to the conventional wisdom, should aim for stable prices, with a slight bias toward inflation to stimulate the "animal spirits" of businessmen and shoppers. In the ten years prior to the 2008 financial crisis, independent central banks set an inflation target of about 2%, in order to provide economies with a price-stability "anchor." There should be no expectation that prices would be allowed to deviate, except temporarily, from the target. Uncertainty relating to the future course of prices would be eliminated from business calculations.

Obama Steps Up

Simon Johnson

For the past six years, US President Barack Obama’s administration has, more often than not, sided with the interests of big banks on financial-sector policy. But this week, announcing a new proposal to prevent conflicts of interest in financial advising, Obama seemed to turn an important corner. From the outset of his first presidential term, Obama maintained the approach taken by George W. Bush’s administration. Large financial firms benefited from the provision of massive government support in early 2009, and their executives and shareholders received generous terms. Citigroup, in particular, benefited from this approach, which allowed it to carry on with substantially the same business model and management team. And the Dodd-Frank financial-reform legislation of 2010 could have done much more to curtail large banks’ power and limit the damage they can cause. Most recently, in December 2014, the administration abandoned an important part of the Dodd-Frank reforms – a move that directly benefited Citigroup by allowing its management team to take on more risk (of the kind that almost broke the financial system in 2007-08). Among financial-industry lobbyists and House Republicans, the knives are out to roll back more of the constraints imposed on Citigroup and other big banks.


Europe’s Chimerical Capital-Markets Union

Howard Davies

The eurozone’s survival is in doubt again, as Greece demands debt forgiveness and an end to austerity – or else. But, though Europe’s currency union is at risk, and its banking union remains at an early stage of development, the endlessly creative European Commission is embarking on another adventure: a so-called “capital-markets union.” That “so-called” is appropriate, because the project, despite being only vaguely defined at this point, is most certainly not intended to create a single European capital market. Indeed, European Union leaders know better than to announce such an ambition, which would require a new treaty – no one is prepared to open up that can of worms. After all, European voters are in no mood to transfer more powers to Brussels. The capital-markets union actually began as a slogan, coined by one of EU Commission President Jean-Claude Juncker’s acolytes. Now, the new financial markets commissioner, the United Kingdom’s Lord Jonathan Hill, has been assigned the unenviable task of putting flesh on bare bones. The Commission’s “Green Paper” consultation round on the subject produced more questions than answers.

Emerging Economies’ Demographic Challenge

Martin Neil Baily, Jaana Remes

Population aging is often cited as a major economic challenge for the developed world. But a new report from the McKinsey Global Institute (MGI) shows that shifting demographics pose an even greater threat to the growth prospects of many emerging economies. Over the last 50 years, the world’s 1.6% annual population growth fueled a surging labor force and a rapid increase in GDP in many emerging economies. Employment more than doubled in China and South Africa, and at least tripled in Brazil, India, Indonesia, Mexico, and Nigeria. In Saudi Arabia, employment increased almost nine-fold. But, with population growth slowing, average annual employment growth in emerging economies is expected to drop from 1.9% to 0.4%. In absolute terms, the decline will exceed that of developed economies, where annual employment growth is expected to fall from 0.9% to 0.1% the coming years. In most economies, employment is expected to reach its peak within the next half-century; in China, the labor force could shrink by 20% over this period. Of course, there are exceptions to this trend. Indonesia and South Africa are projected to continue to experience rising employment (albeit at slower rates). Nigeria’s labor force is expected to triple from 2014 to 2064, and many other economies in Sub-Saharan Africa will experience similar levels of growth.


Making Do With More

J. Bradford DeLong

In the United States, just three out of ten workers are needed to produce and deliver the goods we consume. Everything we extract, grow, design, build, make, engineer, and transport – down to brewing a cup of coffee in a restaurant kitchen and carrying it to a customer’s table – is done by roughly 30% of the country’s workforce. The rest of us spend our time planning what to make, deciding where to install the things we have made, performing personal services, talking to each other, and keeping track of what is being done, so that we can figure out what needs to be done next. And yet, despite our obvious ability to produce much more than we need, we do not seem to be blessed with an embarrassment of riches. One of the great paradoxes of our time is that workers and middle-class households continue to struggle in a time of unparalleled plenty. We in the developed countries have more than enough to cover our basic needs. We have enough organic carbon-hydrogen bonds to break to provide us with calories; enough vitamins and other nutrients to keep us healthy; enough shelter to keep us dry; enough clothing to keep us warm; enough capital to keep us, at least potentially, productive; and enough entertainment to keep us from being bored.