tepav

economic policy research foundation of turkey

Pace of European Union enlargement after the crisis

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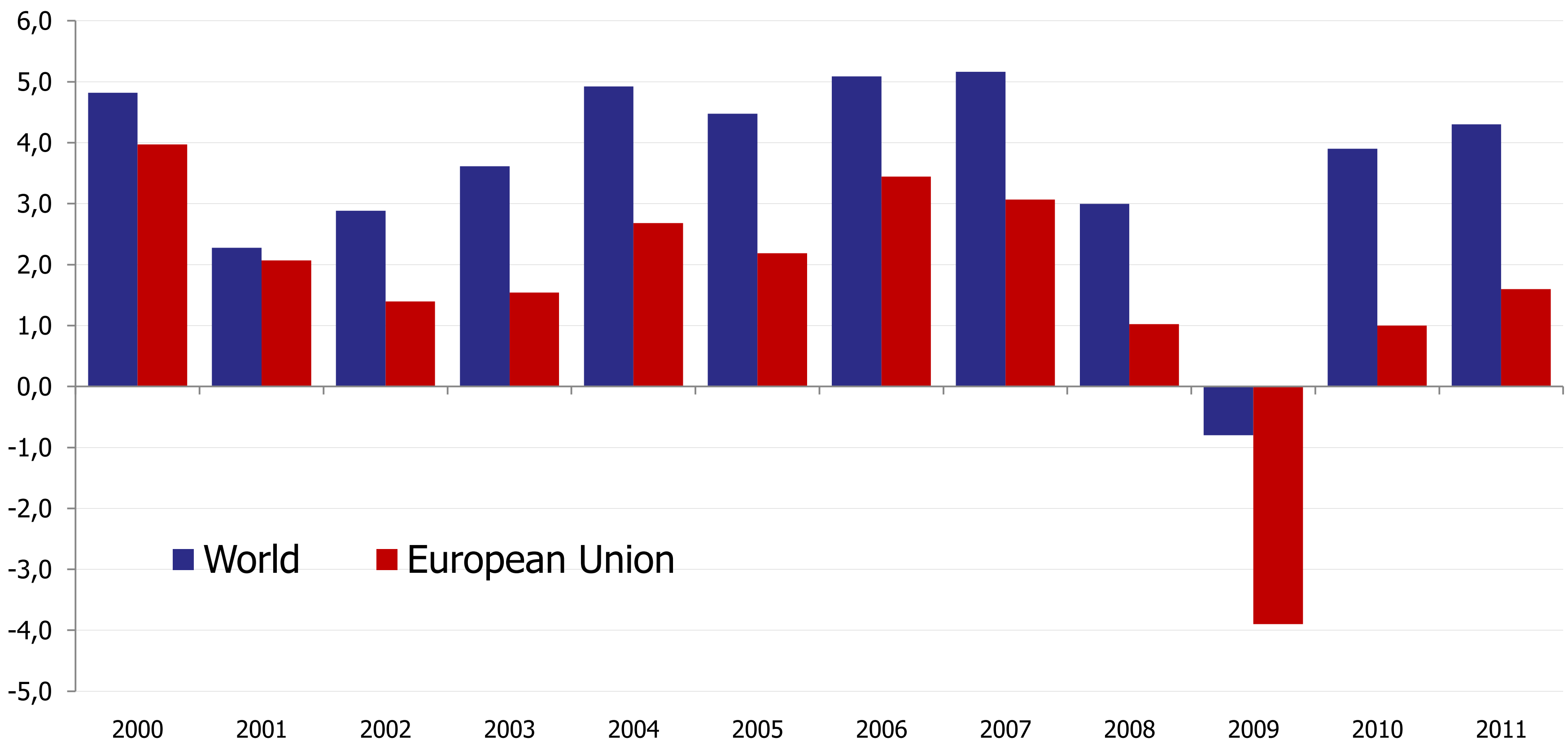
Framework

- Which crisis are we talking about?
  - 2008 global crisis or the PIGS one?
- What are the salient features of PIGS?
  - Creative accounting in Greece only triggered
  - Deep structural problems
- What does Turkey have in common with PIGS?
  - Similar structural problems
- Implications for Turkey’s accession
  - What do we have to do?

Slow recovery in Eurupe…

GDP Growth Rates (%) of EU-27 and World Output, 2000-2011



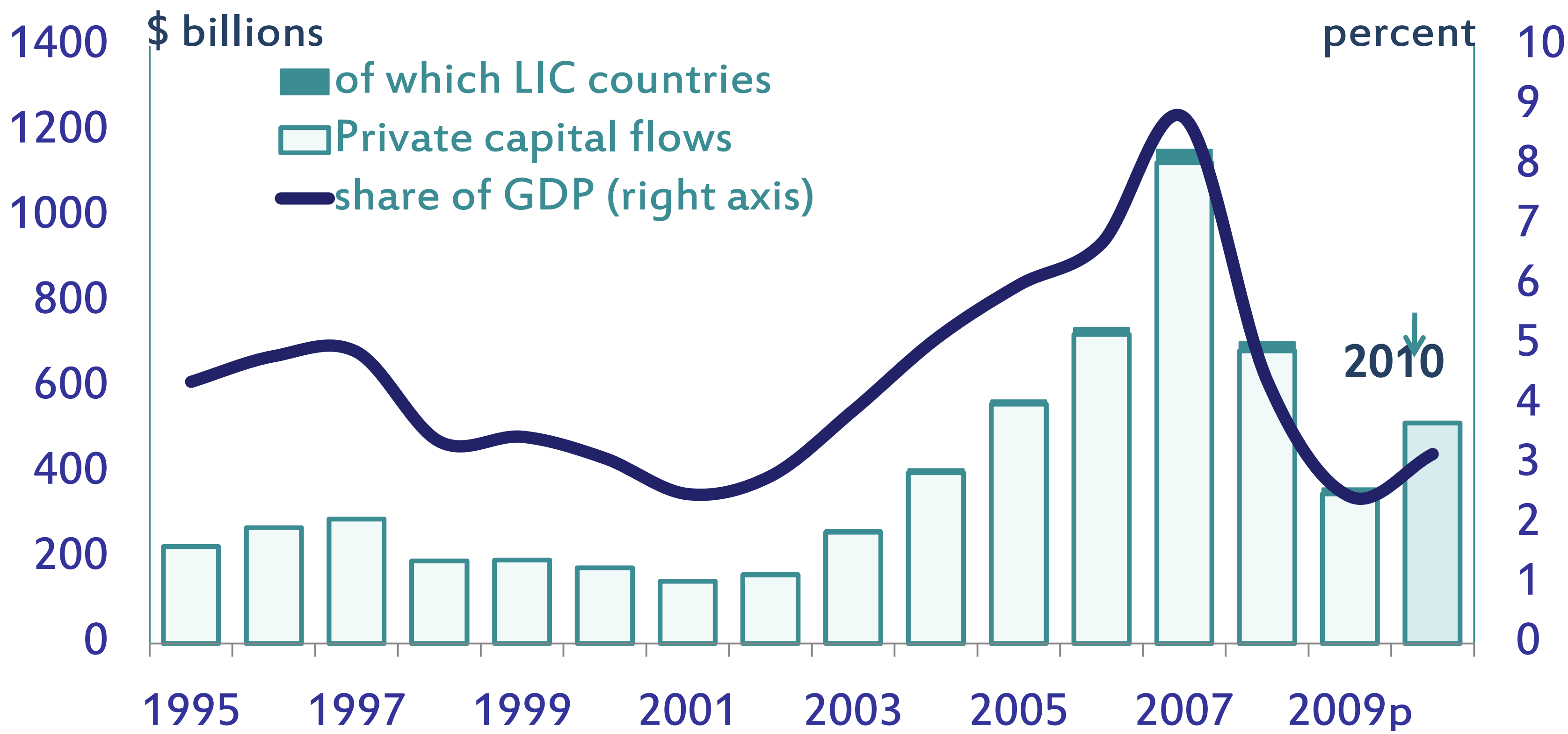
Source: WEO, Oct.09

We thought it was all over

- Slow recovery in Europe
- International fund flows recovering?
  - Still at low levels
  - Picky or more risk averse investors at the moment
- Risk averse investors have now a tendency to distinguish
  - PIGS are on the bad side
  - We're yet to see where Turkey is

Private capital flows are unlikely to recover to the pre-crisis levels for some time

Net private capital flows to developing countries



Source: World Bank, Global Economic Prospects 2010: Crisis, finance, and growth

It was already bad for enlargement, look at it now

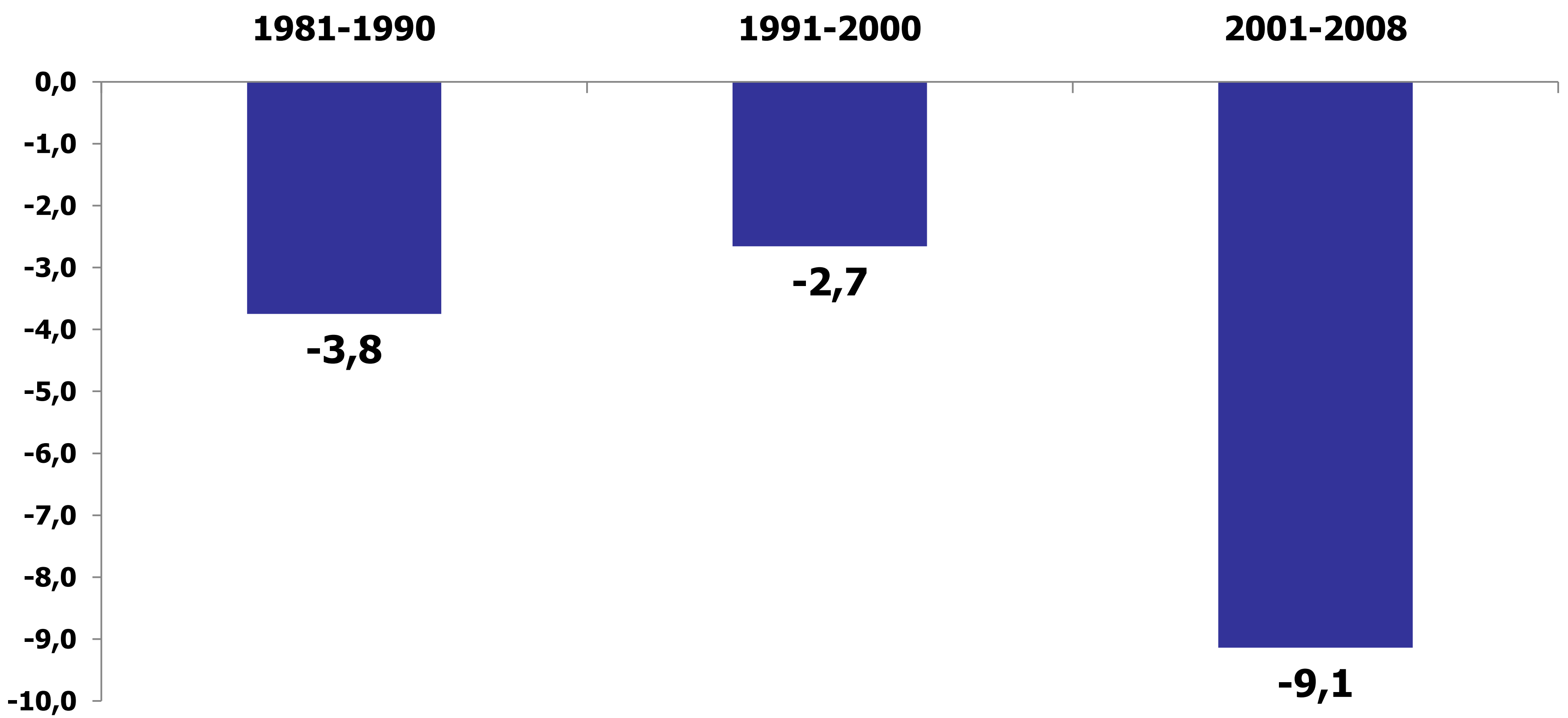
- Low growth, high unemployment, worsening public accounts already bad for enlargement
- EU has shown its coordination deficiency at the time of the crisis.
  - ➔ Better in the US because no need to waste this much time for stimulus package coordination.
  - ➔ Similar argument for the tax system. Nothing identical.
- A new problem emerged with PIGS
  - ➔ Structural problem
    - Low savings, current account, and fiscal policy
  - ➔ EU has no functioning mechanism to address

Salient features of PIGS

- New entrants?
  - Ireland 1973
  - Greece 1981
  - Spain 1986
  - Portugal 1986
  - Italy 1958
- All Mediteranean?

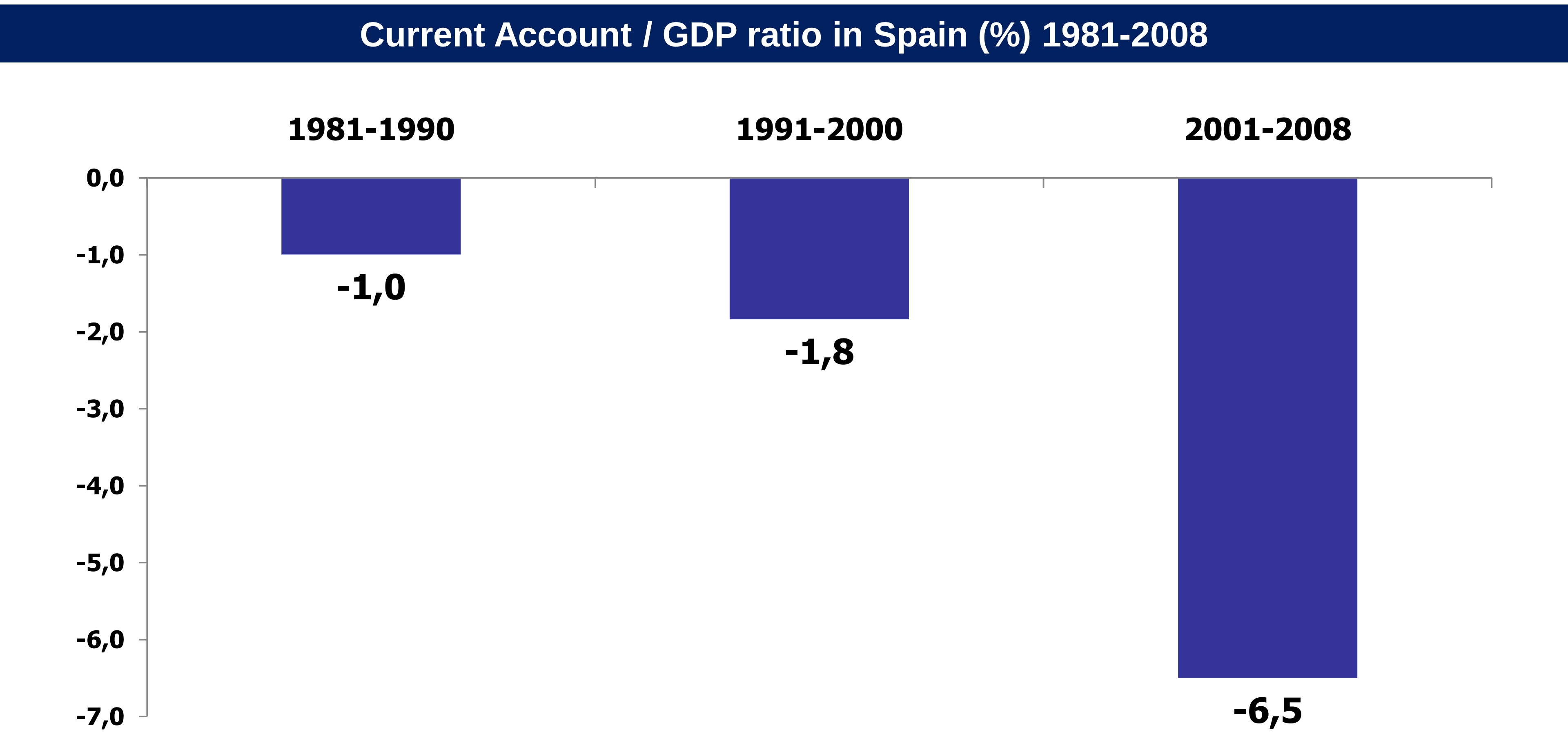
Greece: a jump in current acount deficit in 2000s

Current Account / GDP ratio in Greece (%) 1981-2008



Source: World Bank, World Development Indicators

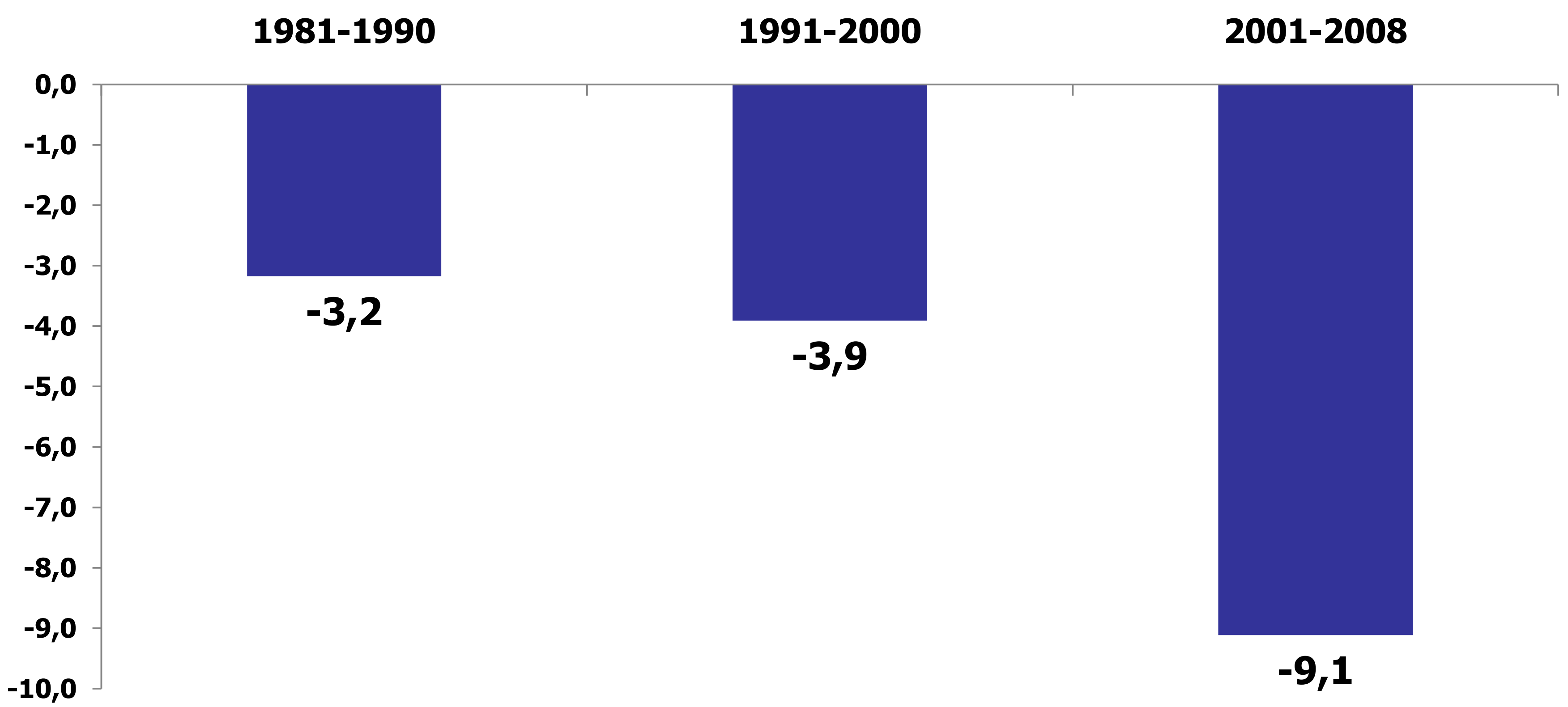
Similar jump in Spain's CA deficit



Source: World Bank, World Development Indicators

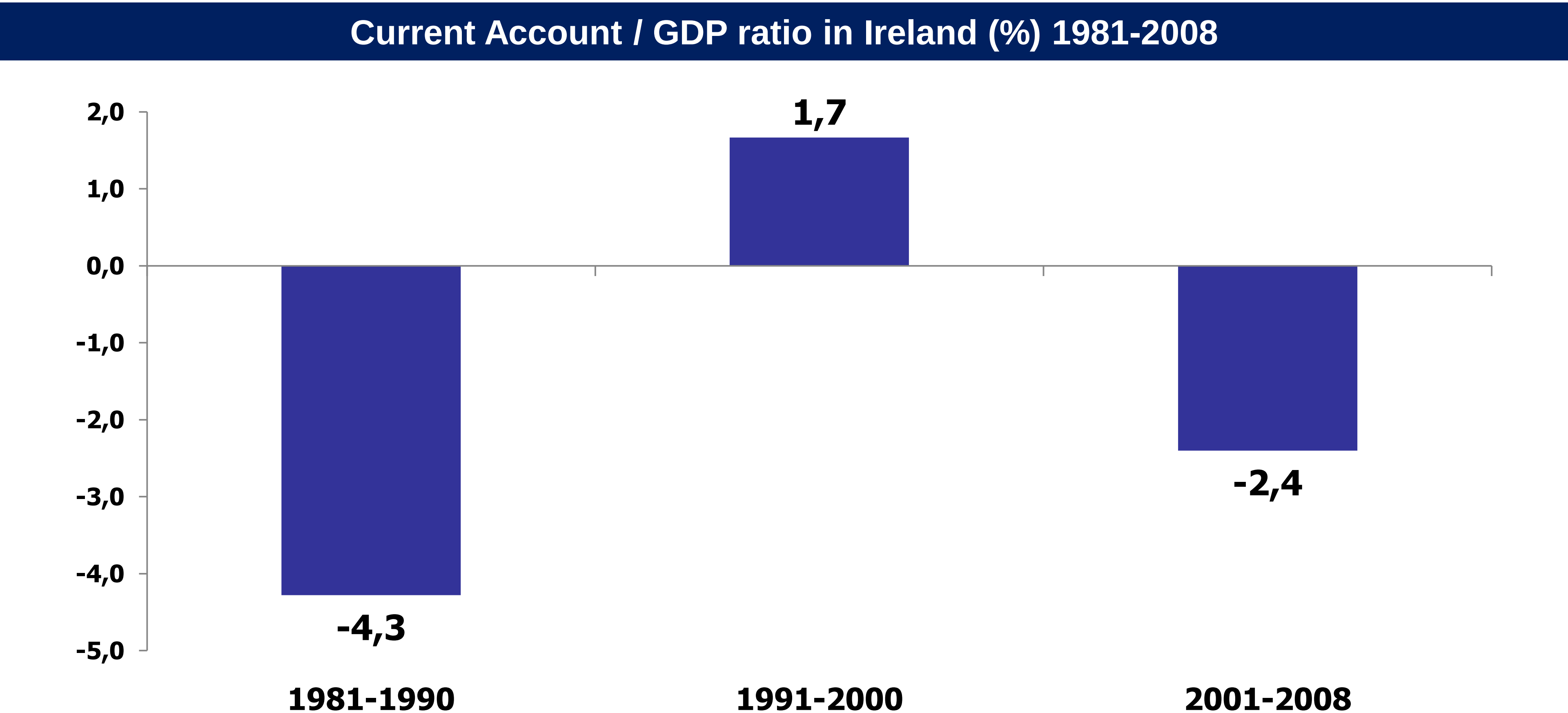
CA deficit in Portugal: is it just a coincidence?

Current Account / GDP ratio in Portugal (%) 1981-2008



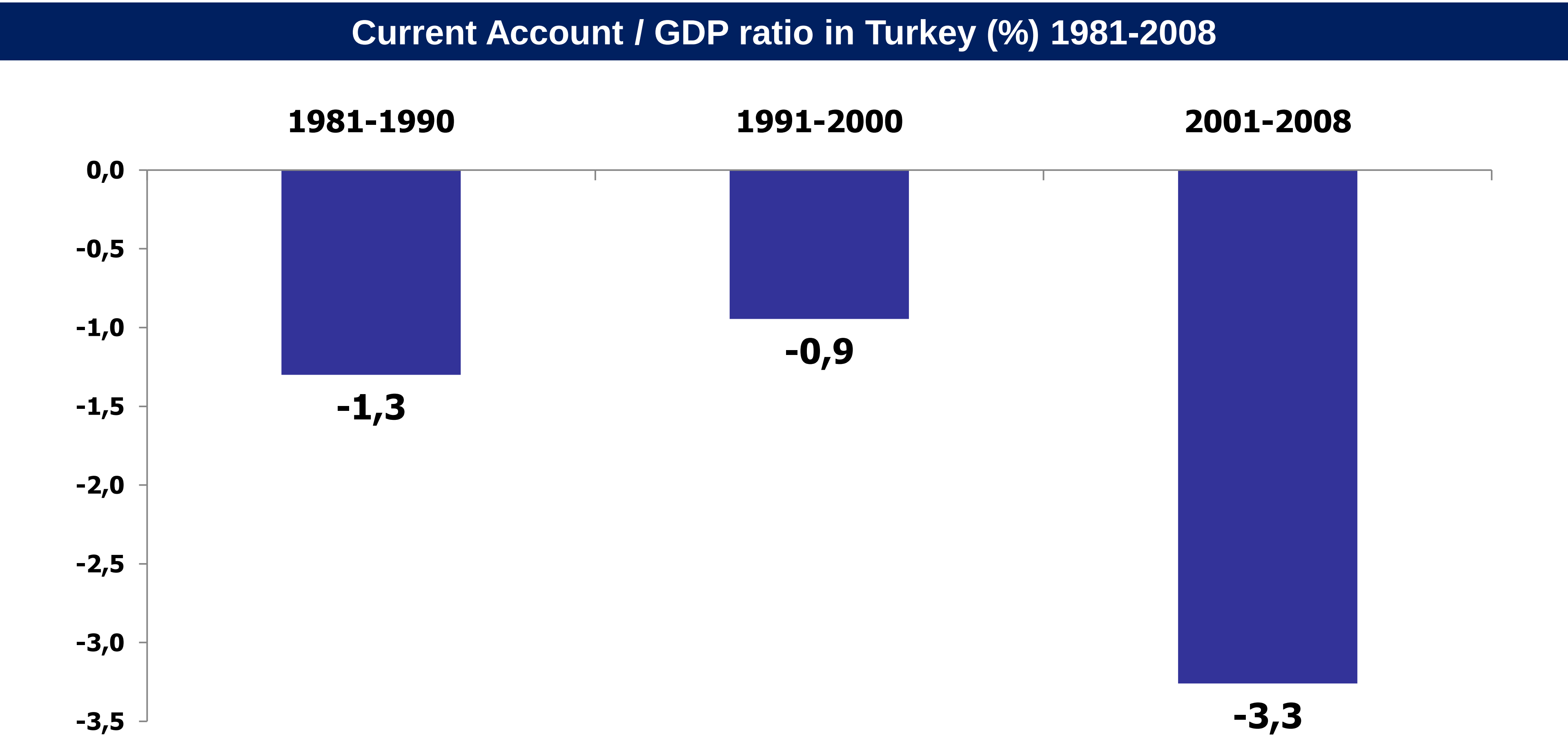
Source: World Bank, World Development Indicators

Ireland is doing relatively better in CA deficit



Source: World Bank, World Development Indicators

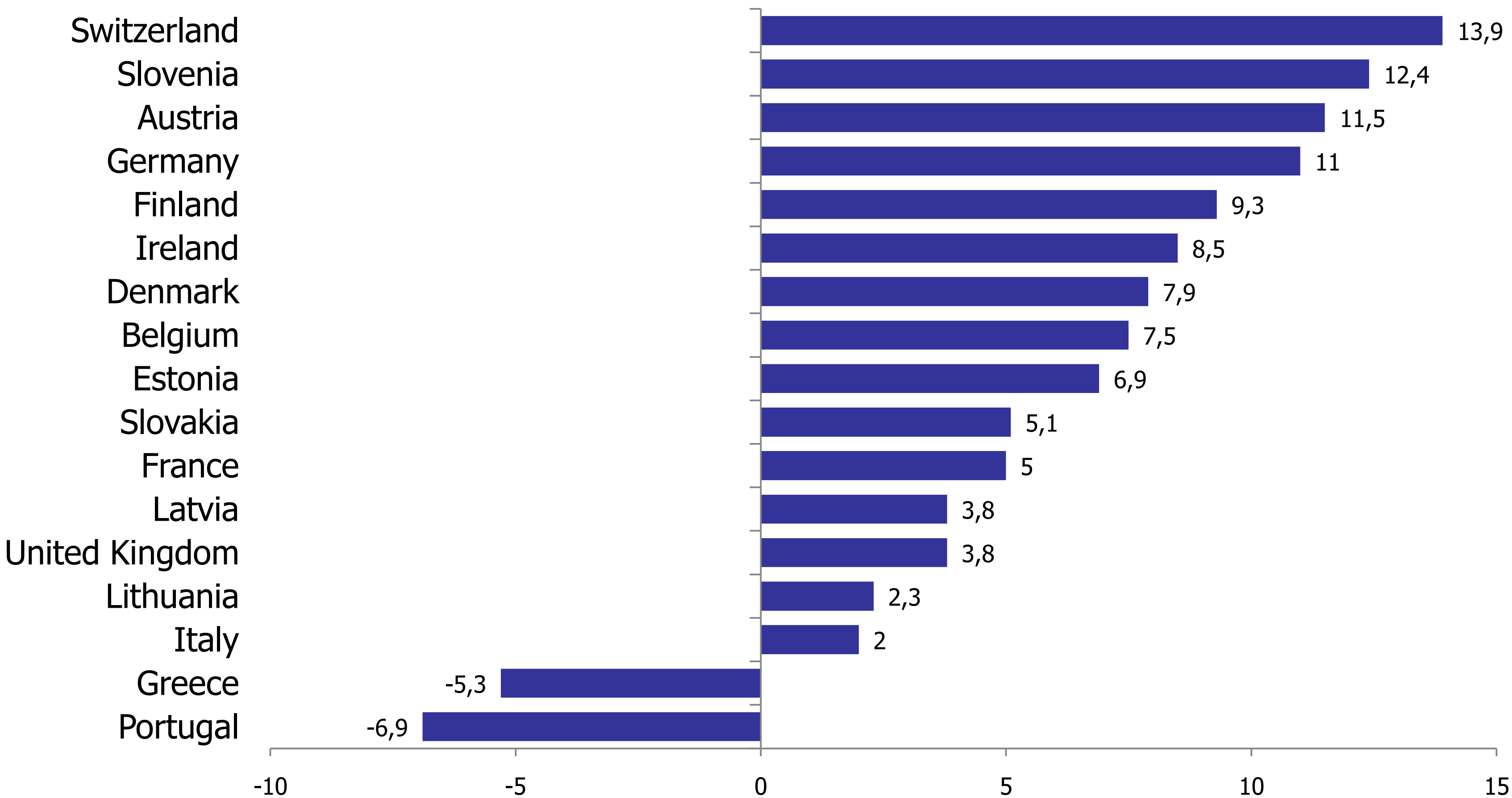
How about Turkey's CA deficit?



Source: World Bank, World Development Indicators

Puzzling saving pattern across Europe

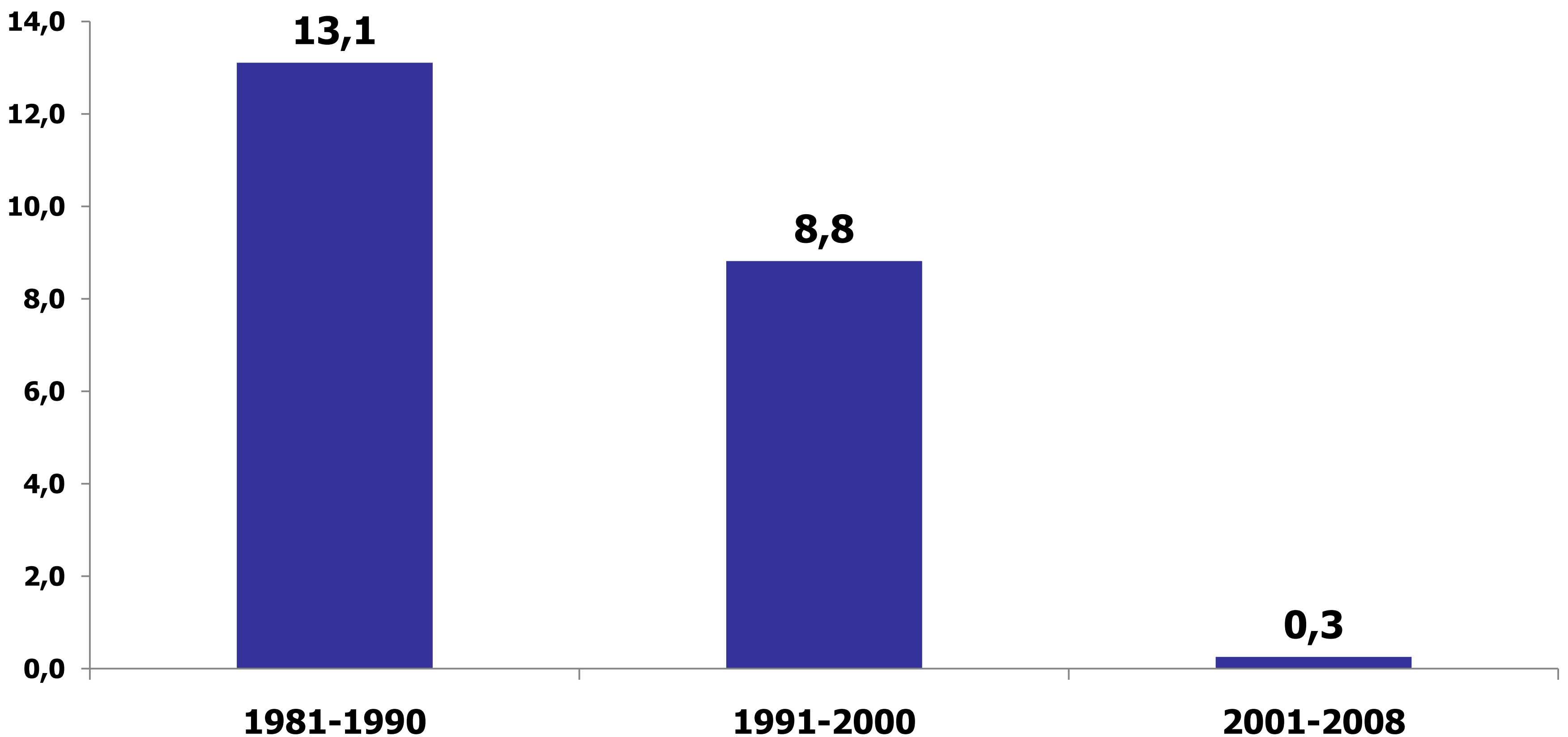
Net Saving Rates across Europe (Net National Saving/GDP, %, 2007-08 Average)



Source: Eurostat

Greece simply cannot save anymore…

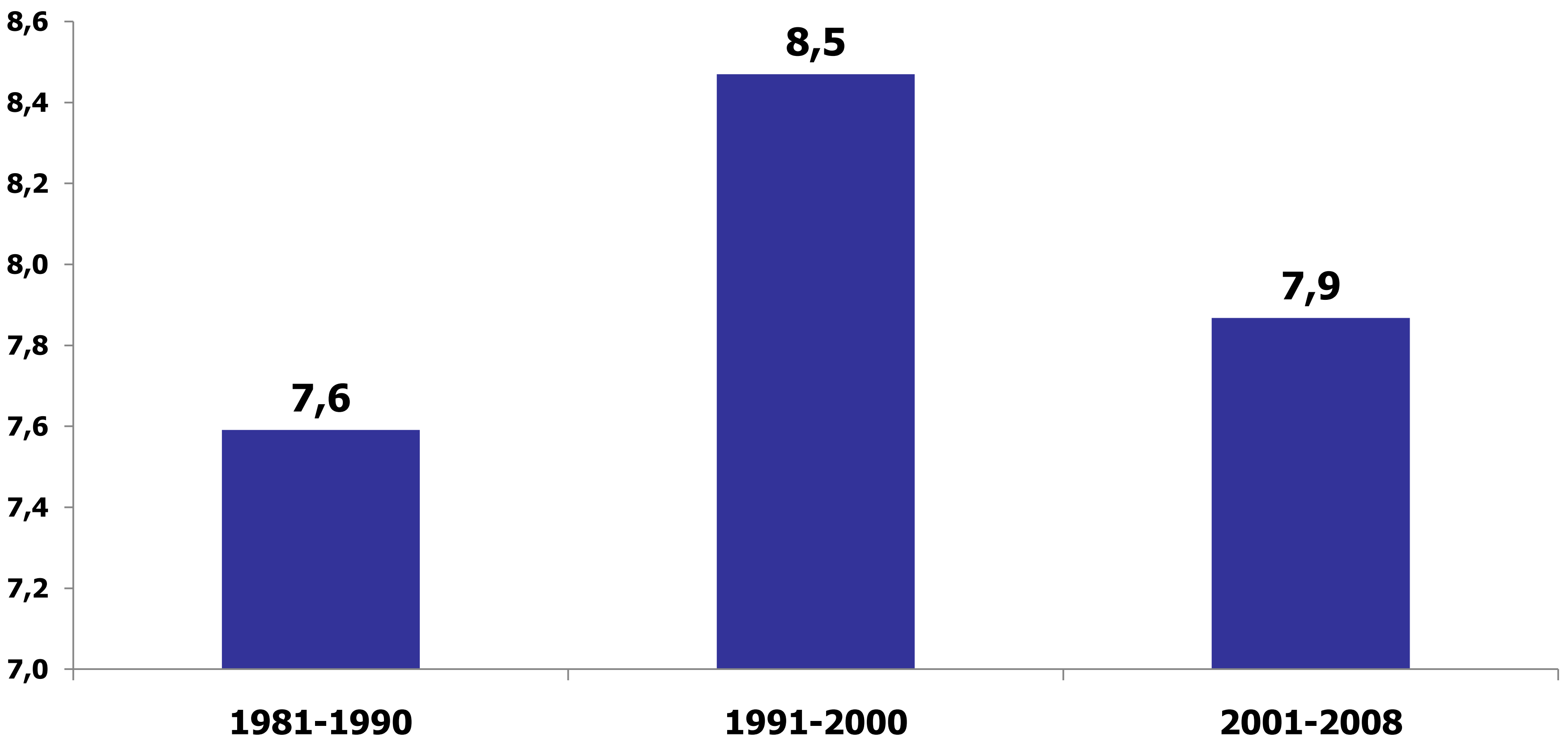
Net Domestic Savings / GDP ratio in Greece (%) 1981-2008



Source: World Bank, World Development Indicators

Spain does better than Greece in terms of savings, but there's a decline there too

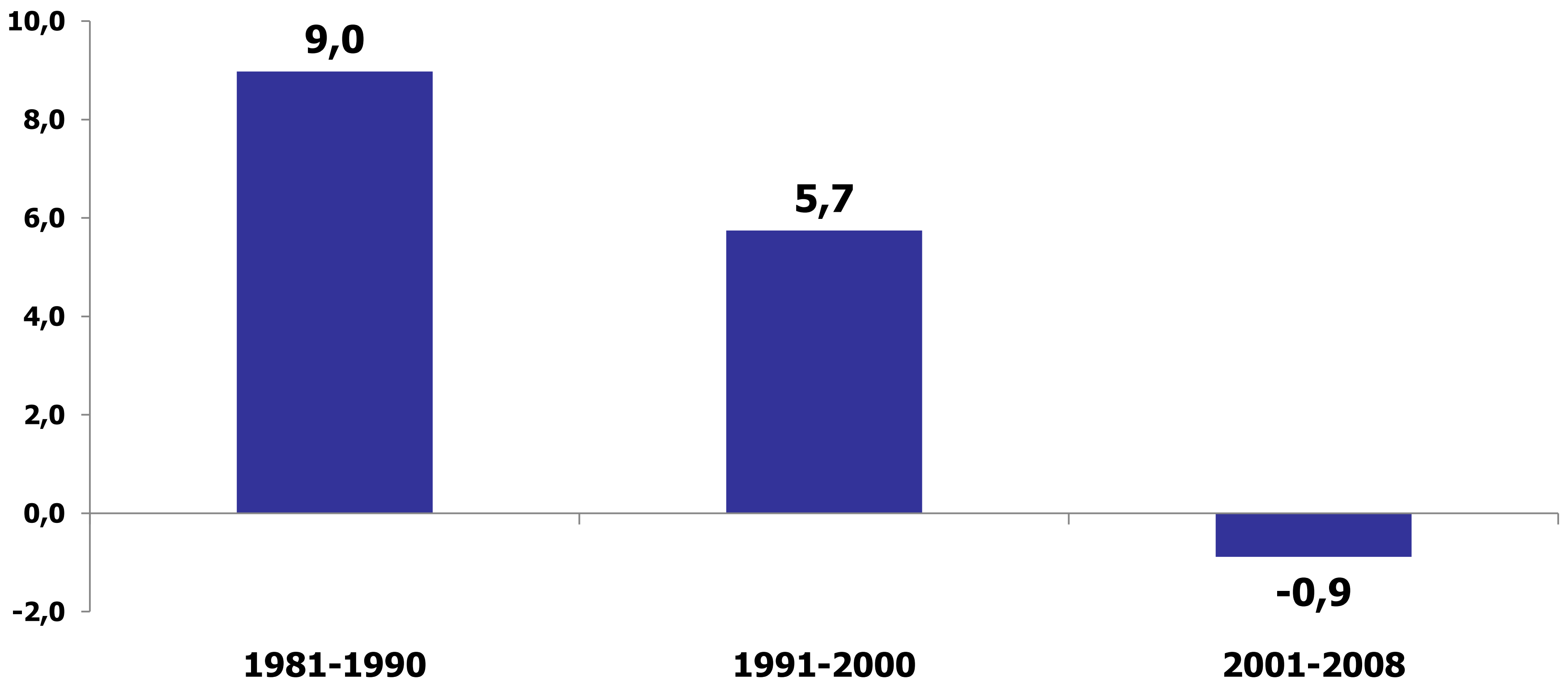
Net Domestic Savings / GDP ratio in Spain (%) 1981-2008



Source: World Bank, World Development Indicators

Portugal is even worse than Greece, with negative savings…

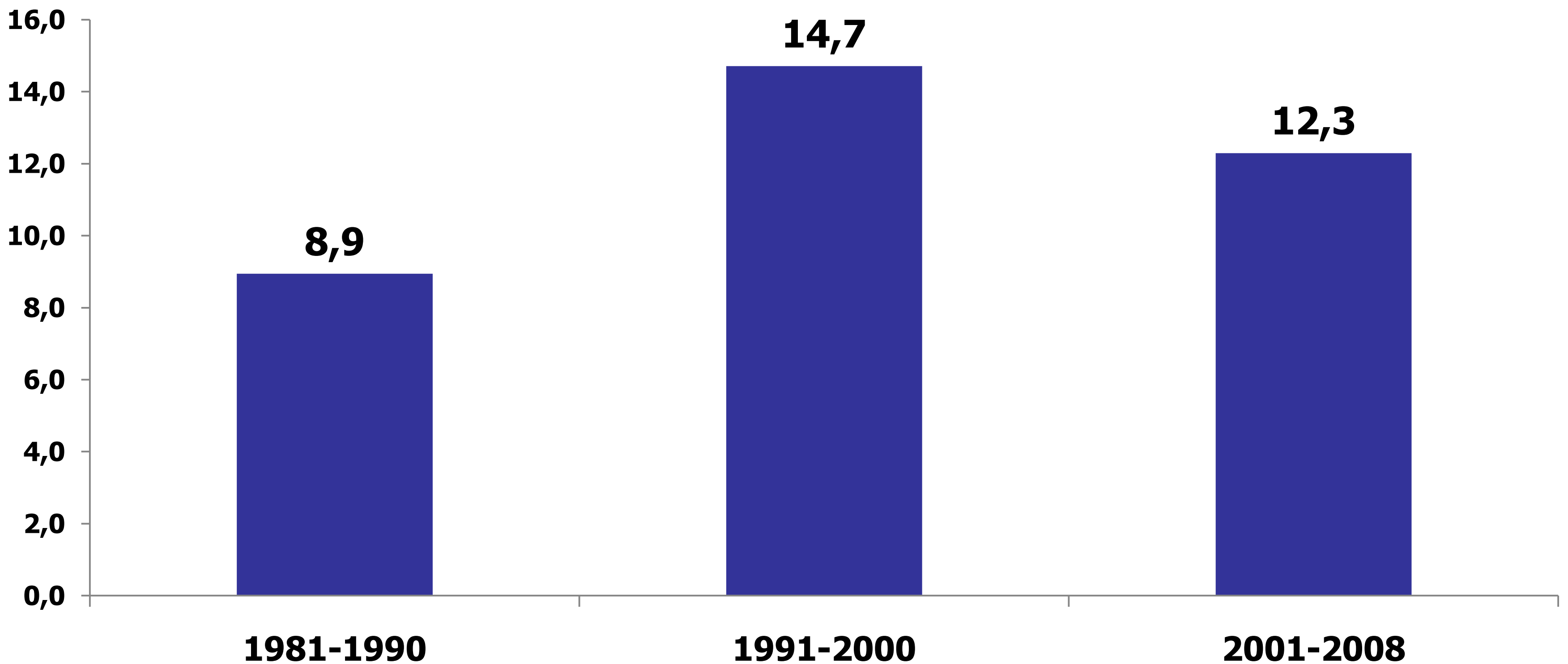
Net Domestic Savings / GDP ratio in Portugal (%) 1981-2008



Source: World Bank, World Development Indicators

There is no obvious savings problem in Ireland

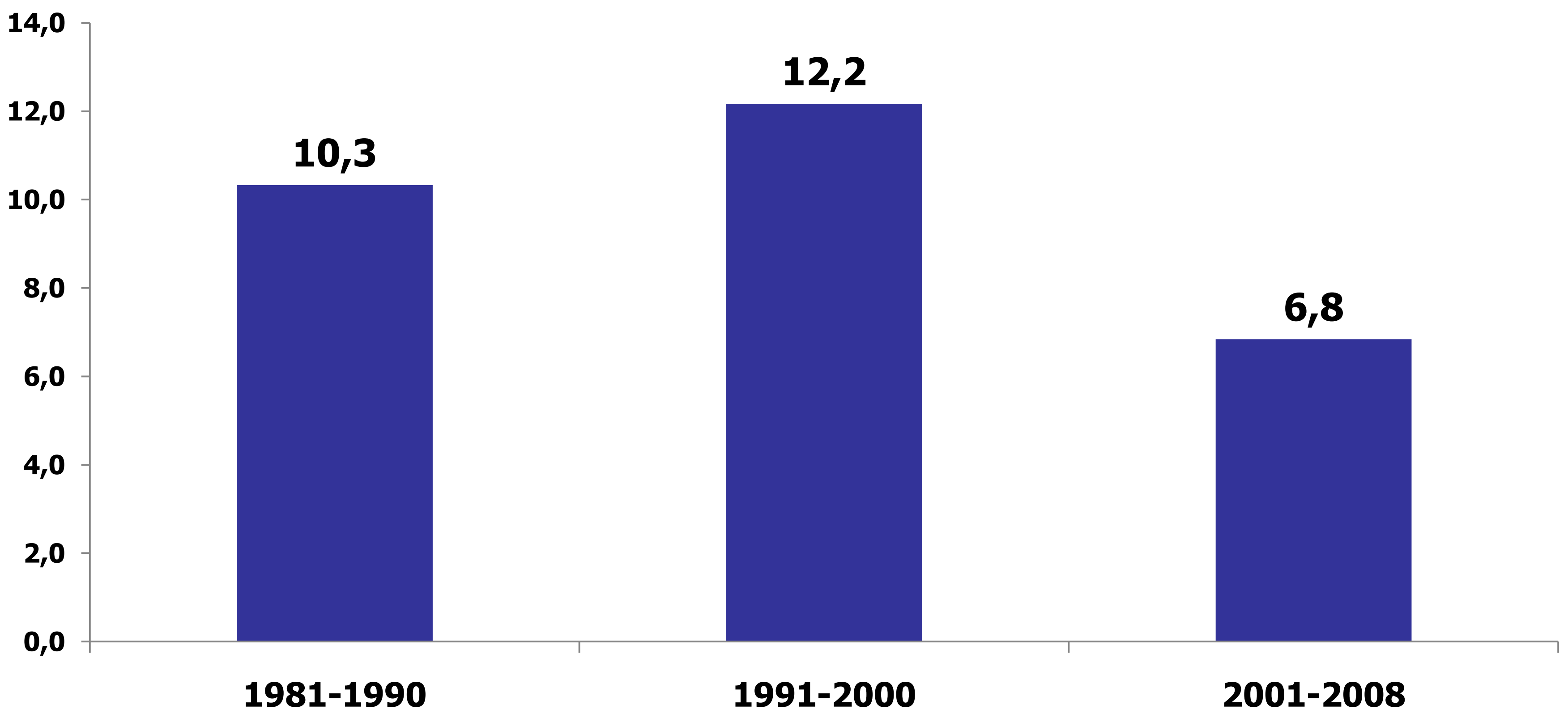
Net Domestic Savings / GDP ratio in Ireland (%) 1981-2008



Source: World Bank, World Development Indicators

Low savings is a critical problem for Turkey as well

Net Domestic Savings / GDP ratio in Turkey (%) 1981-2008



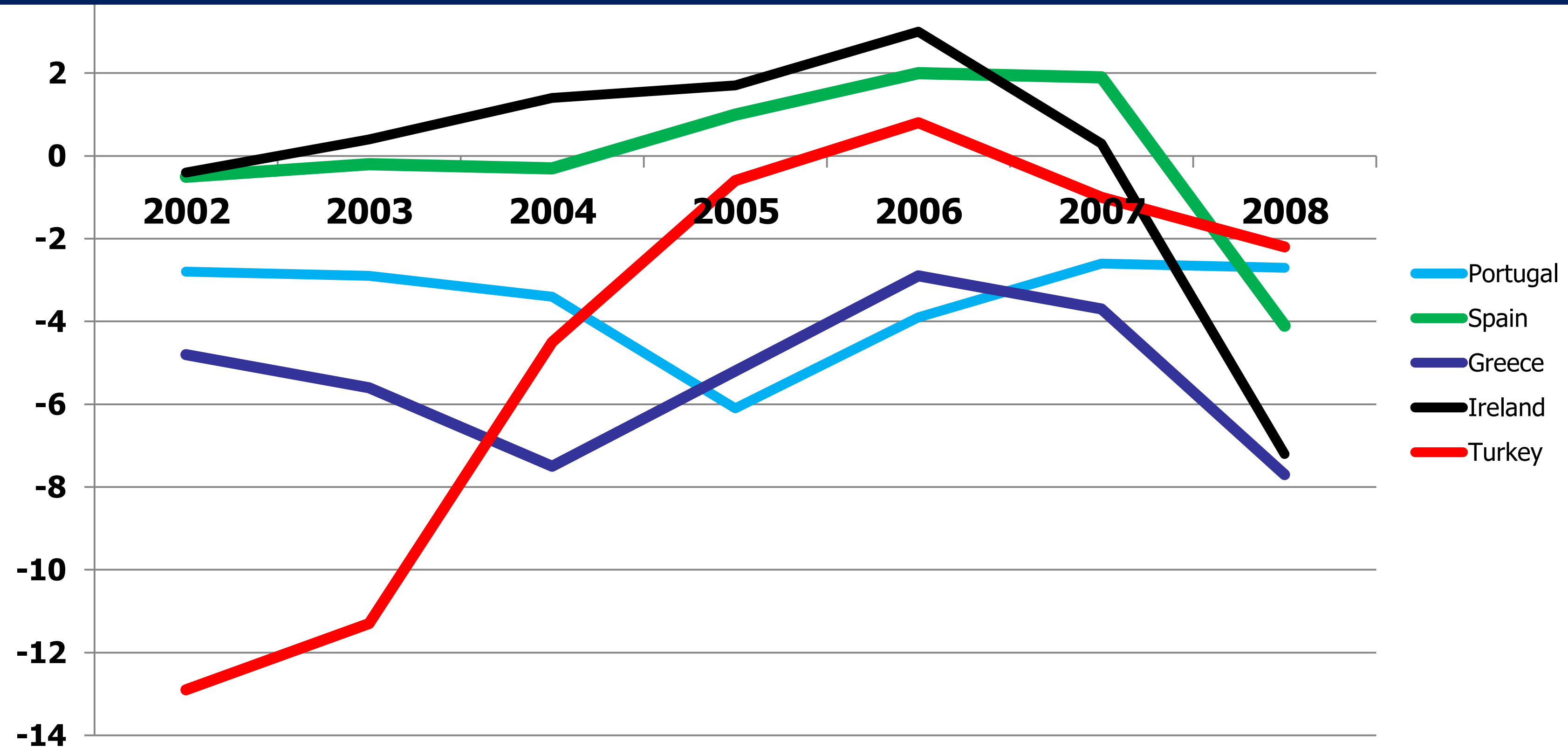
Source: World Bank, World Development Indicators

Why domestic savings tend to decline?

- Becoming an EU member: capital flows to countries where the institutional structure is the one that the investors know of.
- Blanchard and Giavazzi (2002)
  - → Decline in savings not an increase in investments (Greece, Portugal, Spain)
  - → Greater financial and trade integration
    - Lower interest rates- like the home country
    - Case of Puerto Rico and US in the 1950s.

Recent deterioriation in government deficit in all five countries

General government deficit (-) and surplus (+); Percentage of GDP, 2002-2008, Portugal, Spain, Greece, Ireland and Turkey



Source: Eurostat

EU convergence itself is to blame

- Global crisis is not the only reason, there are also structural reasons.
  - ➔It is not only the fault of Greece.
- In order to catch up, you need to grow beyond your means
  - ➔If no fiscal discipline mechanism, sustainable growth may have problems.
  - ➔That is what seems to have happened in all five countries

What is the missing link?

- Stronger fiscal coordination mechanism for the convergence process.
- Wyplosz and Krogstrup, 2009
  - → Chile, Brazil (formal)
  - → UK, Informal "Code for Fiscal Stability"
  - → Belgium, High Council of Finance
  - → Denmark, Netherlands, Sweden, Wisepersons committees to inform the public.
- Needed especially if domestic savings either low or declining
  - → Look at the PIGS/high-growing budget deficits

Why EU needs to interfere?

- Single currency prevents automatic stabilization
  - ➔No depreciation of the currency
- How to organize the rescue operation?
  - ➔ IMF
  - ➔ EU should have a mechanism
- IMF looks to be the practical solution at the moment.
- Fiscal rule and strong Brussels coordination for the enlargement process in the medium term.

What is the way out?

- Countries with fiscal problems have to obey fiscal discipline rules
  - → Unlike EU but it has to be something like this
- Enlargement under the new “normal”.
  - → Fiscal rule and Fiscal policy councils to ensure the credibility of fiscal rule.
  - → From IMF to EU conditionality

More policy coordination requirement slows down the enlargement process?

- Policy coordination only?
- EU conditionality?
- Good news for TR?
- There is a new issue in EU agenda
  - → Fiscal coordination
  - → After Maastricht what?
    - Not for the core but for the periphery?

What is the issue for TR now?

- Issue is to achieve sustainable, stable growth
  - Lower the fluctuations in the growth rate
  - High current account deficits are bad.
- How to cope with it?
  - Increase domestic savings? Unlikely
  - Increase the tax base and collect more? Unlikely till 2014
  - Put a cap on government expenditures? Doable---Fiscal rule.

Conclusion

- 2008 crisis was already bad for the pace of enlargement
  - → Already fiscal problems due to stimuli
  - → No need for additional problems
- PIGS will intensify the worries regarding enlargement
  - → EU cannot say no.
  - → EU has to support Greece.
  - → Time for EU conditionality.
- Ask not what EU can do for you, ask what you can do for yourself now
  - → Structural adjustment problem is to have a macro dimension also
  - → Up until now it has been all micro.