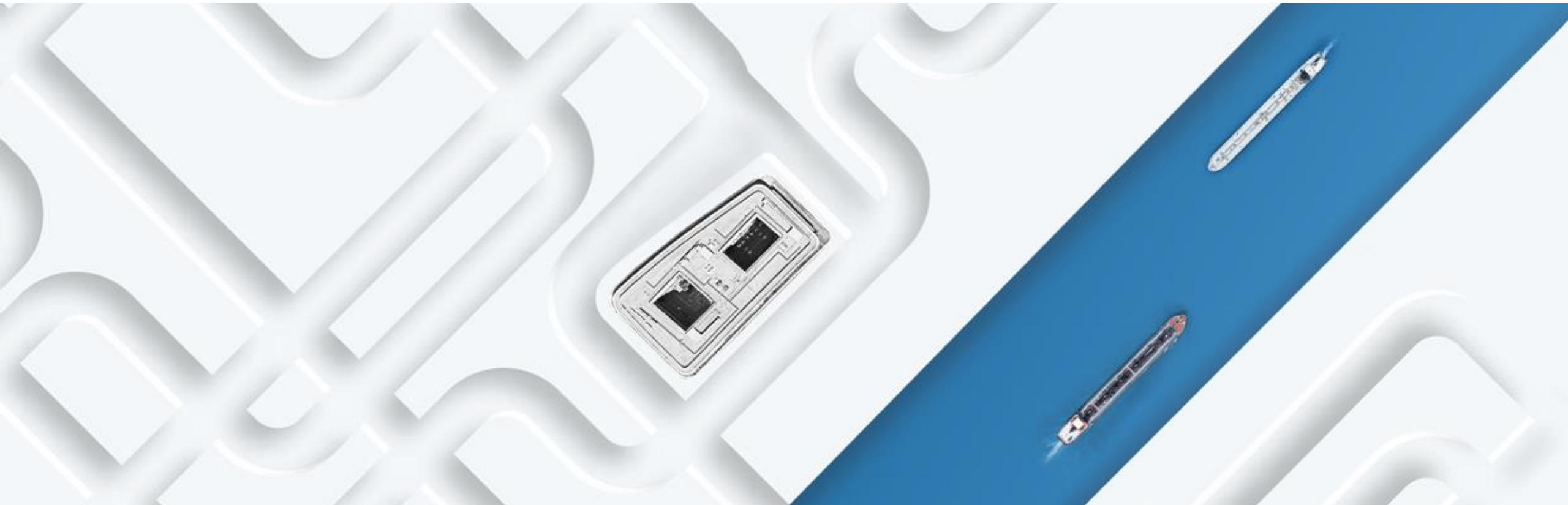


XI. Scientific Conference

The “Great Transformation”: New Rules of the Game?



Agenda

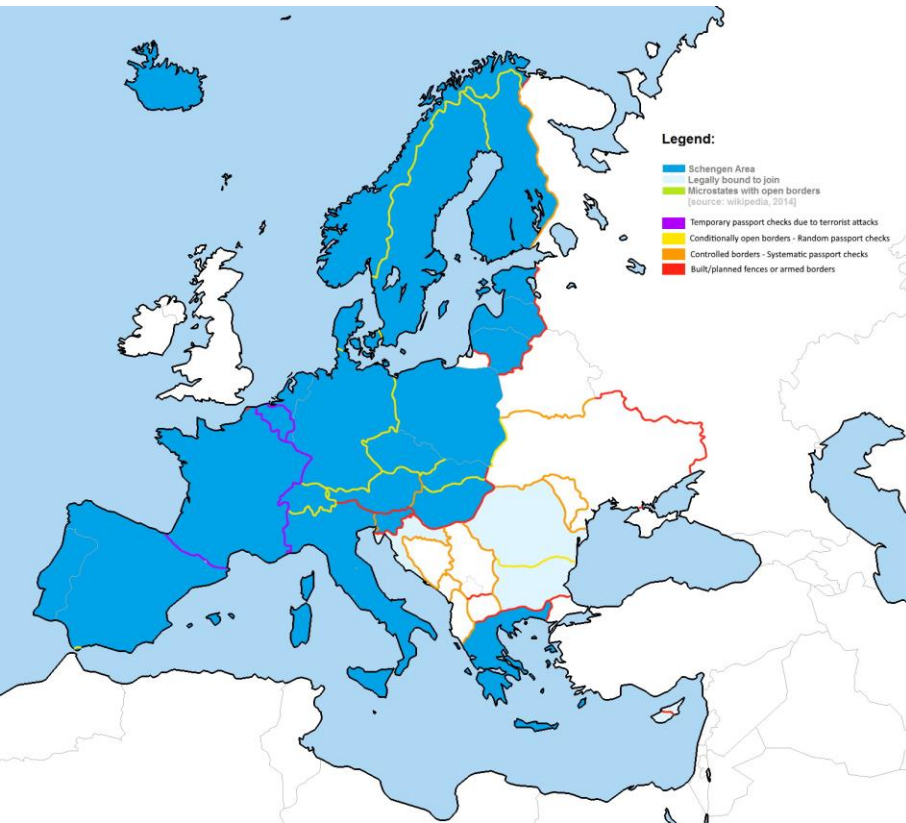
Part I



- 09.00 **Welcome Note and Introduction**
Prof. Dr. Dominik Enste
Head of Research Unit Behavioral Economics and Business Ethics, IW
- 9.10 **Impulse: "Turning point to a new bipolar world: consequences in geopolitics and geoeconomics"**
Dr. Hans-Peter Klös
Head of Research, IW
- 09.30 **Brief Comment**
Prof. Dr. Jens Beckert
Director, Max-Planck-Institute for the Study of Societies
- 09.40 **Round Table Discussion**
Prof. Dr. Dominik Enste (Moderator)
Head of Research Unit Behavioral Economics and Business Ethics, IW
- 10:30 **Coffee Break**

Agenda

Part II



11:00

Impulse: "Reforming the Rules of the Euro Zone / Stability and Growth Pact."

Prof. Dr. Lucio Baccaro

Director, Max-Planck-Institute for the Study of Societies

11:20

Comment: "Reform of the European Stability and Growth Pact"

Jürgen Matthes

Head of Research Unit International Economics and Economic Outlook, IW

11:30

Round Table Discussion

Prof. Dr. Dominik Enste (Moderator)

Head of Research Unit Behavioral Economics and Business Ethics, IW

12:30

Key Take Home Messages of Each Participant

12:45

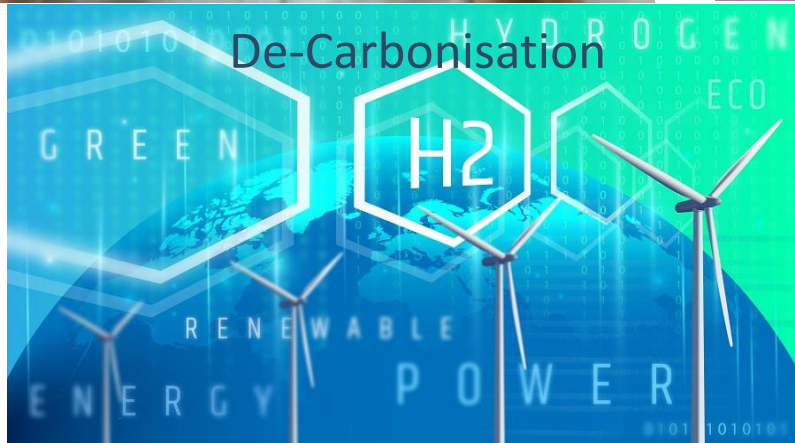
Lunch and Get-Together

Welcome Note and Introduction

Prof. Dr. Dominik H. Enste

6 “D”-rivers for the “Great Transformation”?

Current Challenges for Europe and Germany

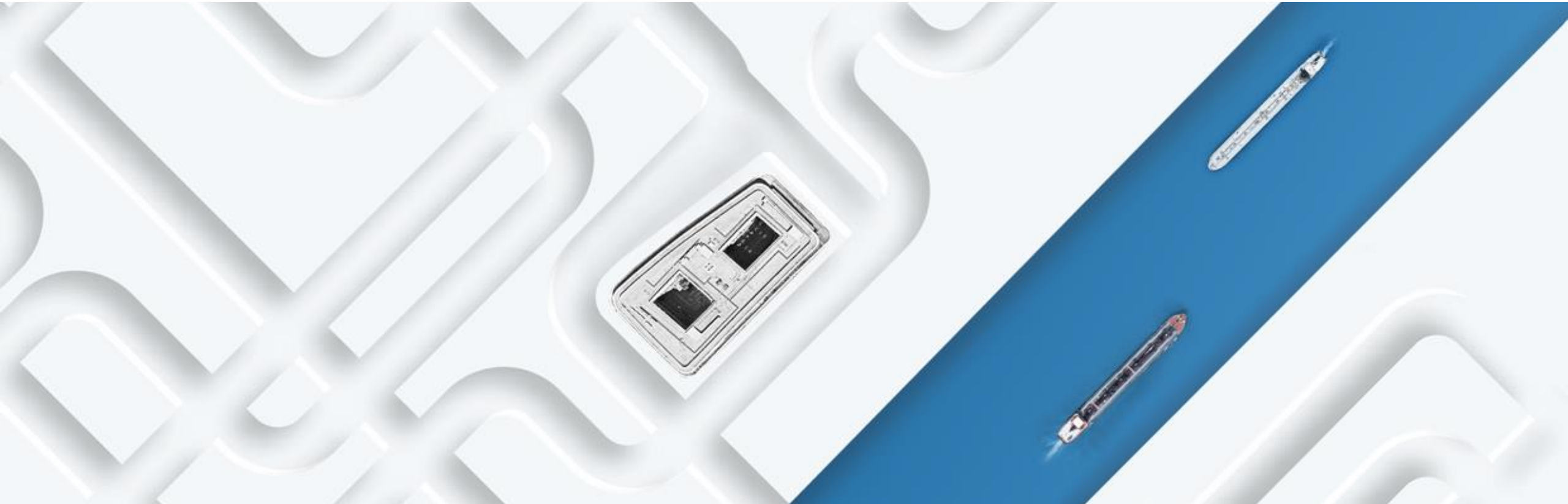


Impulse: “Turning point to a new bipolar world: consequences in geopolitics and geoeconomics”

Dr. Hans-Peter Klös

Turning point to a new bipolar world: consequences in geopolitics and geoeconomics

XI. MPIfG-IW-Conference „The Great Transformation: New Rules of the Game?“



1

Turning point?!

From „Great Transformation“ to „Zeitenwende“

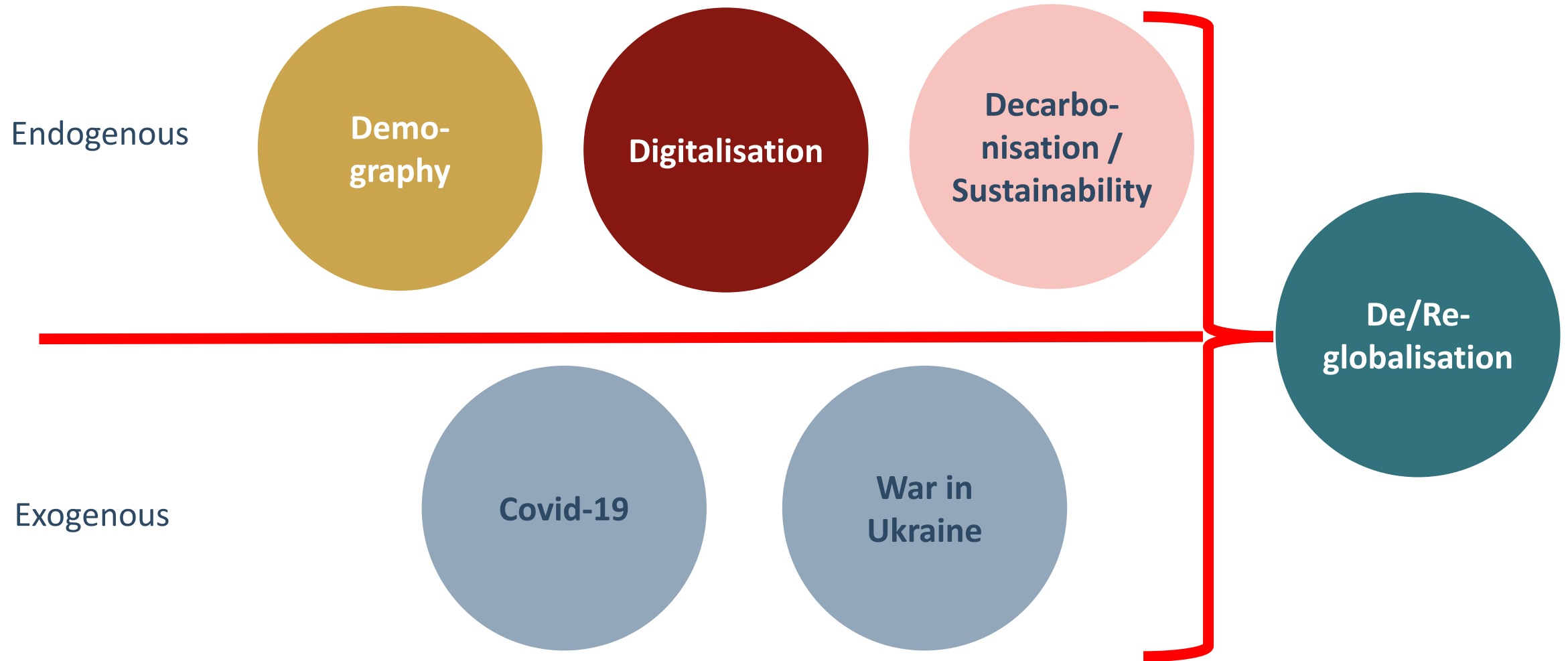
„The world of the 19th century collapsed. This work looks at the political and economic causes of this event and the great transformation it ushered in. [...] Reliance on the gold standard was the creed of the era." (Karl Polanyi, The Great Transformation, 1944, p. 19/47).

We are experiencing a "turn of the times". And that means: The world afterwards is no longer the same as the world before. At its core is the question of whether might can break right. [...] The turning point is not only affecting our country. It affects the whole of Europe. And in this, too, there is both a challenge and an opportunity. The challenge is to strengthen the sovereignty of the European Union in a sustainable and lasting way" (Chancellor Olaf Scholz, German Bundestag, 27 February 2022).

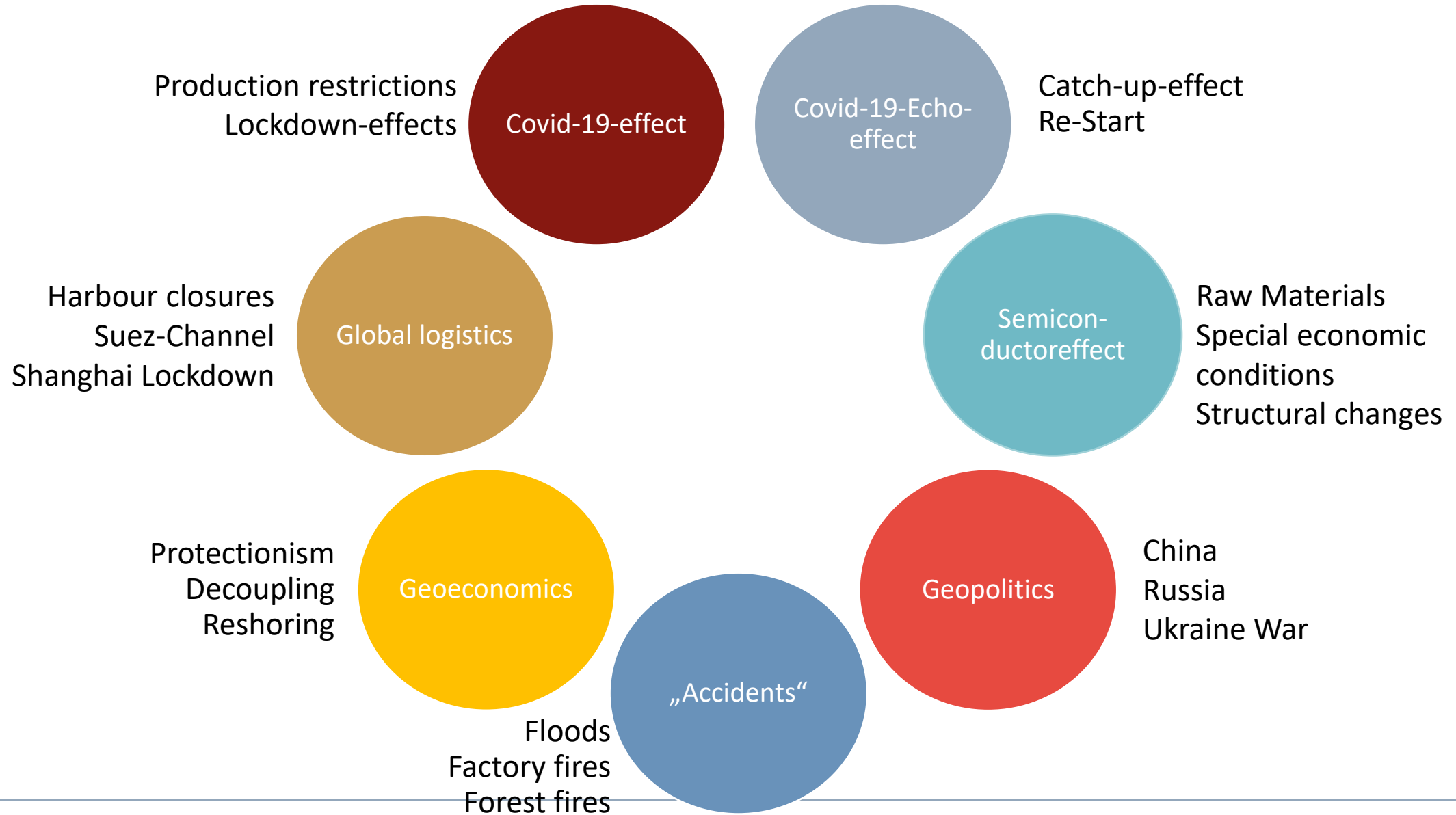
Major Theories of Structural Change

- Karl Marx: The first closed social-scientific theory of transformation with a replacement of a capitalist social order by a classless socialist society.
- Max Weber: The emergence of modern capitalism is based on values and institutions that create the cultural basis for a successful development of the economy and society in the Western world or the Occident.
- Joseph Alois Schumpeter: Replacement of capitalism by socialism because of the successes of the capitalist system as an engine of "creative destruction".
- Karl Polanyi: Transition of the (apparently) functioning agrarian society - with a dominance of estates collectives in 19th century England - into an industrial market society.

Structural Change, transformation or a different world order?

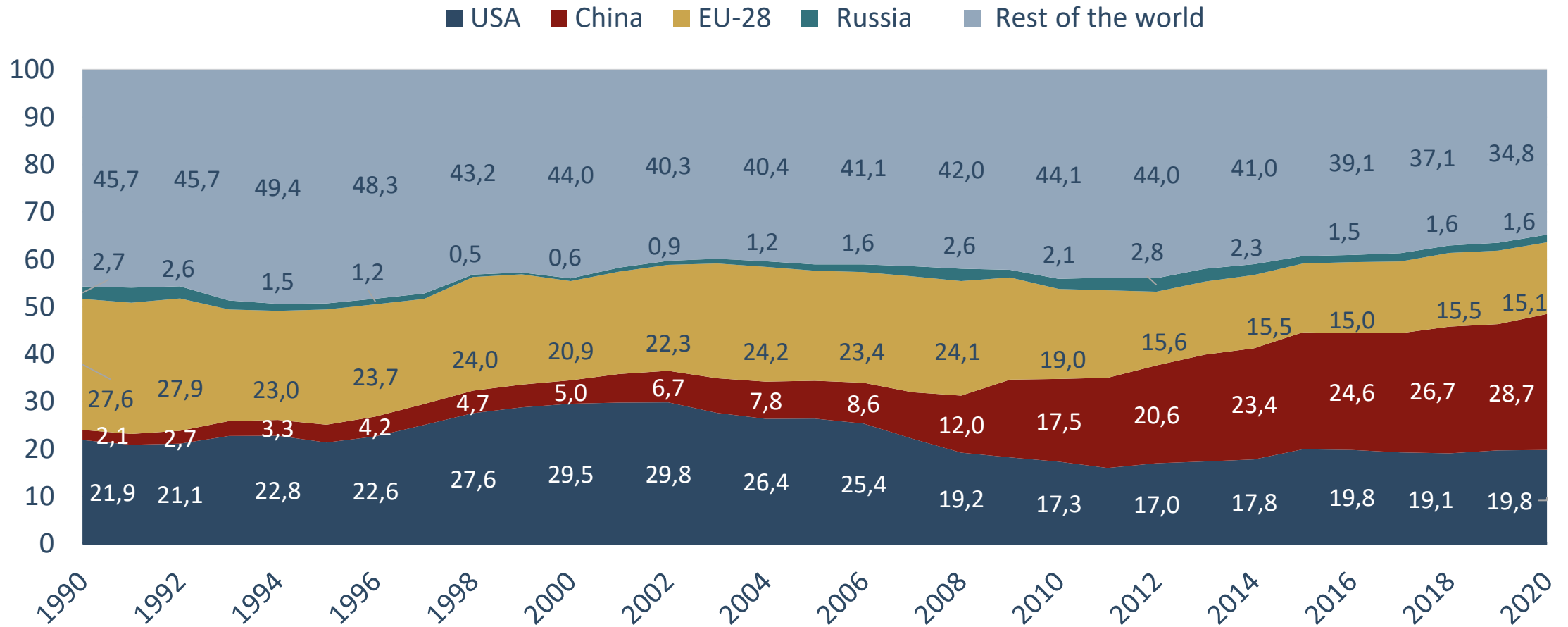


Global Value Chains and their challenges



The „Second Globalisation“: the Rise of China

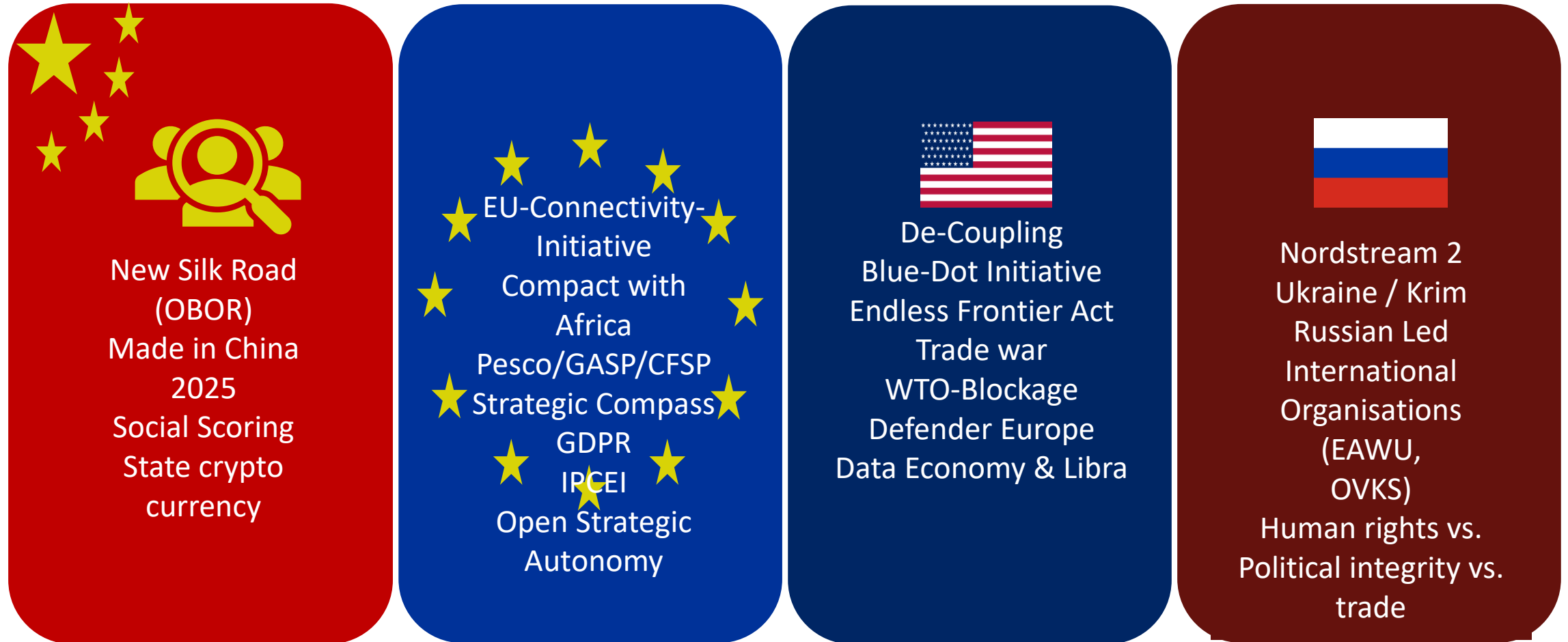
In percent of global investments



Source: World Bank, own representation

From Systemic Competition to Systemic Conflict

Strategies in the Global Power Competition



Europe: Soft power is not enough

From cooperation to confrontation



Aggressive sanctions
Protectionism
Upgrade



Influence through direct
investment
Militarisation



Normative goals
Multilateralism
Diplomatics

Hard Power

Soft Power

2

Consequences

Europe: Have your say in the „bipolar third globalisation“

Rejection of the right of the strongest as an opportunity for democratic systems



Global climate

- Decarbonisation needs control through central hierarchies



Global Health

- Pandemic defence needs international cooperation of national hierarchies



Global trade

- Needs clear sanction mechanisms in case of violation of international regulations

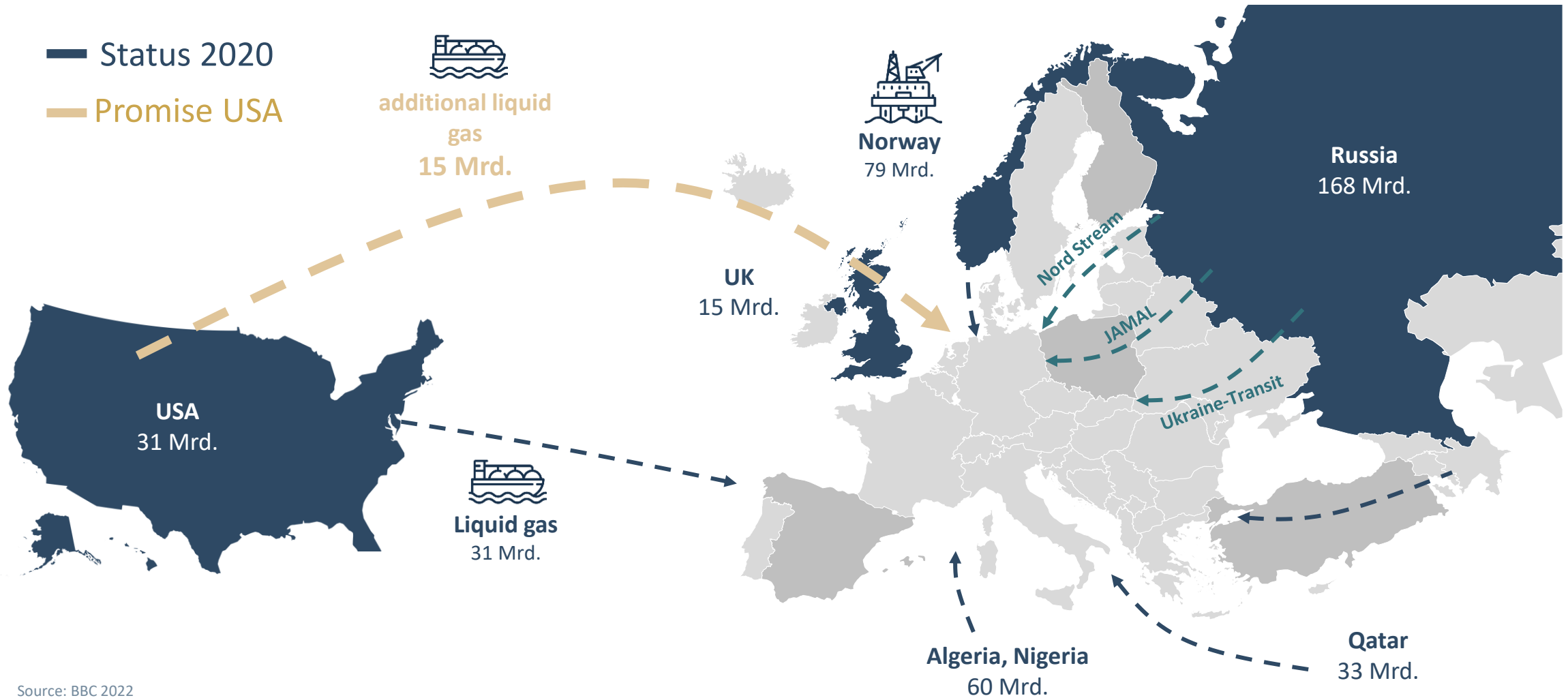


Global security

- Needs definition of minimum standards of global cooperation

Climate and Energy: new partnerships

Imports of natural gas in 2020 in cubic metres



Health: Common European Data Spaces

GAIA-X is

- ...an initiative with the aim of creating a decentralized data infrastructure for the secure, open and sovereign use of data
- ... a future standard whose users can decide for themselves how and where data is used and utilized within the data infrastructure.
- designed to enable cross-industry collaboration to create federated, interoperable services at the infrastructure level and to track data usage on cloud platforms.
- ... organized as a non-profit organization (AISBL) under Belgian law with headquarters in Brussels
- ... an initiative to enable and drive the development of diverse data ecosystems

GAIA-X is not...

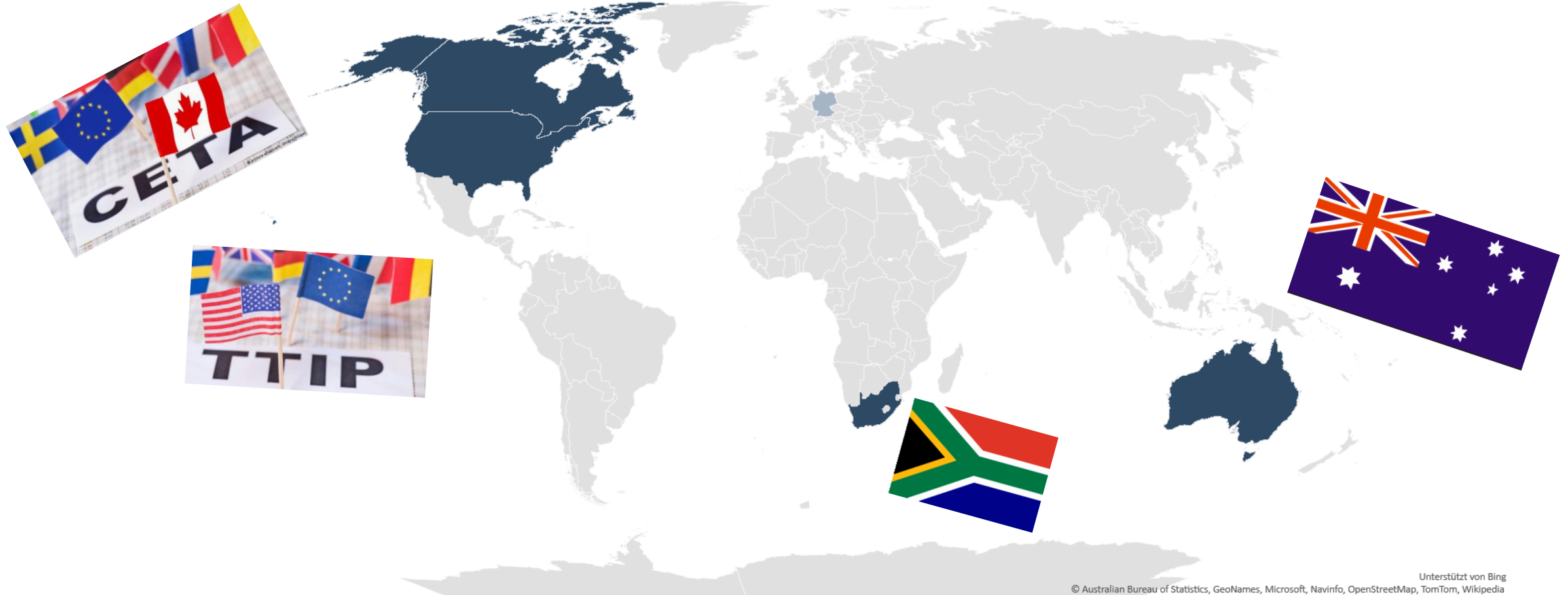
- A single cloud offering, the "Euro-Cloud"
- A replica of a European AWS or similar.
- Users or exploiters of the data and services exchanged via Gaia-X
- A purely academic research project
- For European members only
- A "closed society" for selected partners
- A single ecosystem with a central unit or data lake or similar

»A **real data economy**, on the other hand, would be a powerful engine for innovation and new jobs. And this is why we need to secure this data for Europe and make it widely accessible. We need **common data spaces** - for example, in the automotive or healthcare sectors. This will support innovation ecosystems in which universities, companies and researchers can access and collaborate on data. And it is why we will build a **European cloud** as part of NextGenerationEU - based on GaiaX.« (Ursula von der Leyen)

Quelle: Fraunhofer ISST

Trade: Rule-based Free Trade Agreements

Free trade agreements with other democracies that are rich in raw materials and as stable as possible

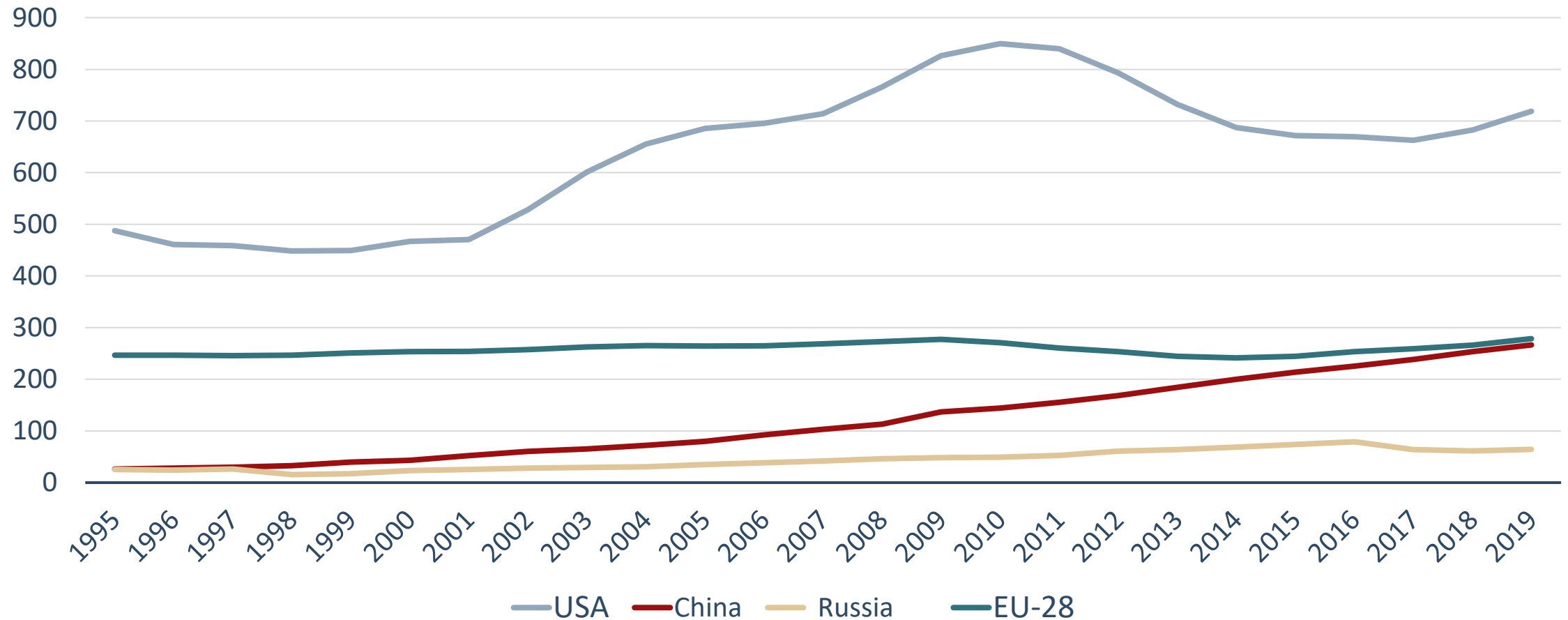


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Picture sources: Deutsche Welle, picture-alliance/K Ohlenschläger; Tagesschau.de

Defence and security: less free riding for Europe

Price-adjusted defence spending in billions of US dollars



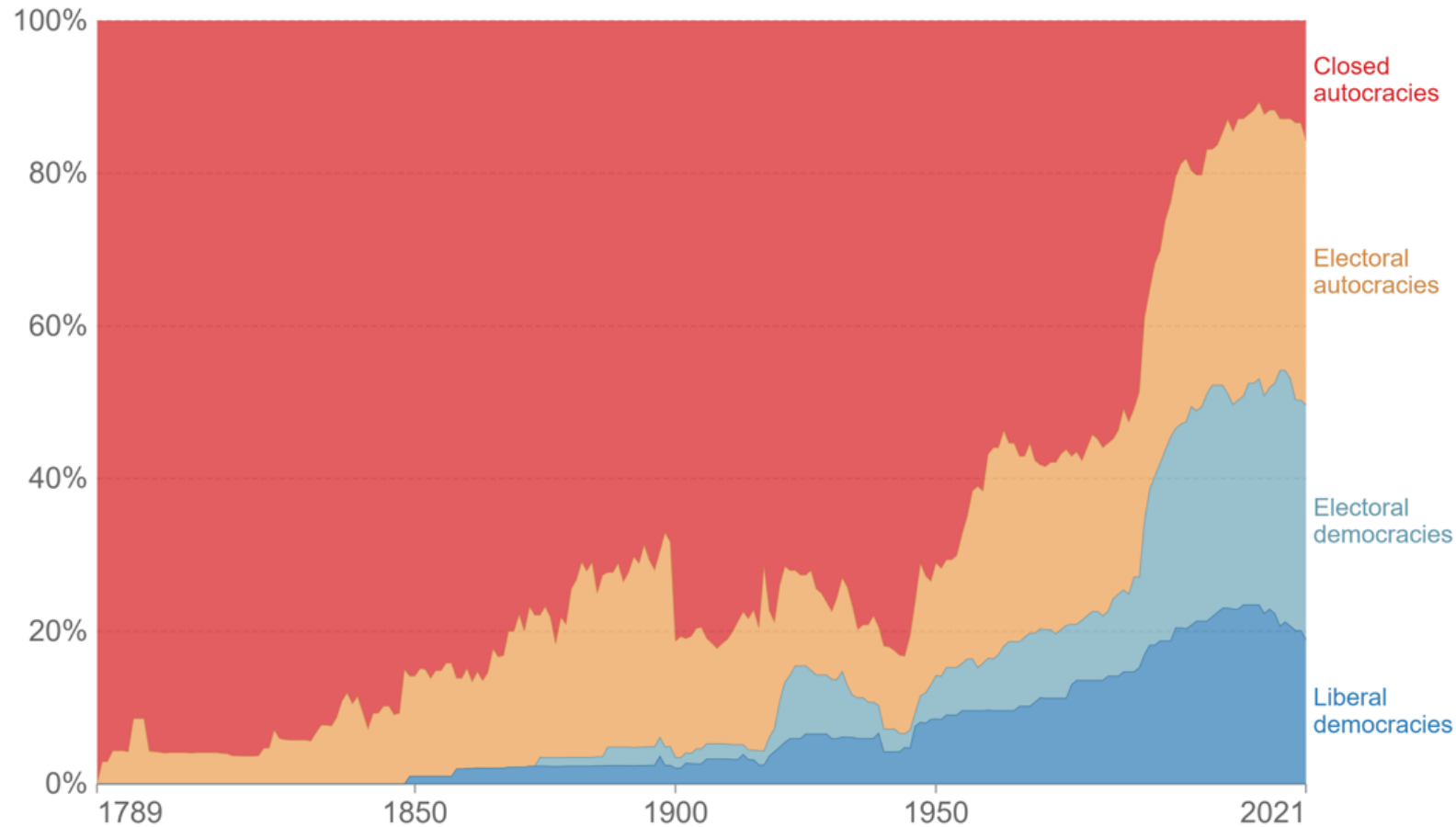
Source: SIPRI; Institut der deutschen Wirtschaft

3

Learnings

Don't Give up, Democracies!

Political regimes based on the criteria of the classification by Lührmann et al. (2018) and the assessment by V-Dem's experts.



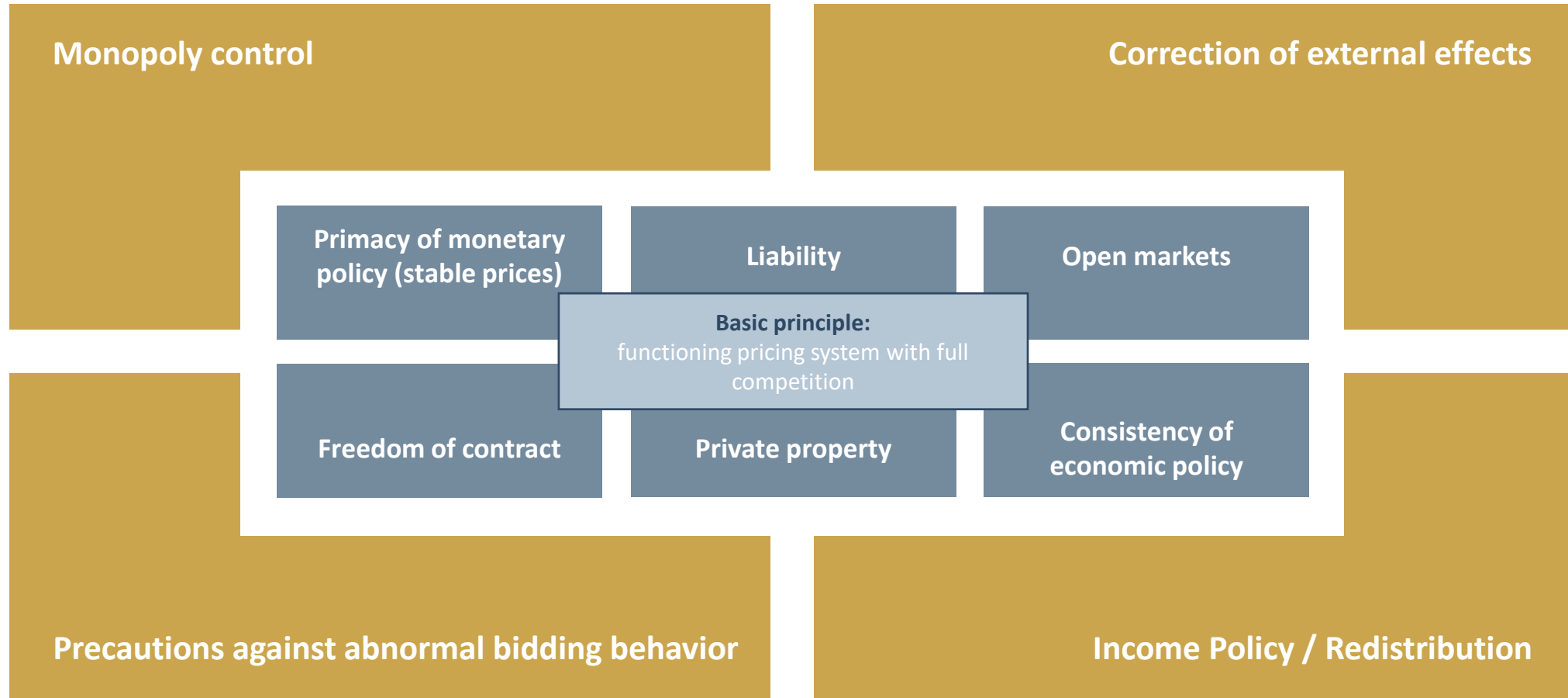
Source: OWID based on Lührmann et al., 2018 and V-Dem (v12); Note: The share of closed autocracies increases a lot in 1900 because V-Dem covers many more countries since then, often colonies.

- About half of the world's countries are now democracies.
- The end of World War I led to the birth of many democracies. After World War II, the number of democracies began growing again.
- But it was the end of the Cold War that led to a more dramatic increase in the number of democracies.
- 2022ff: ???

Institutions matter!

- Ronald Coase, *The Nature of the Firm* (1937): Firms are created to avoid transaction costs. Incomplete information, incomplete rationality or social interactions also lead to costs and uncertainties in market transactions.
- Oliver Williamson, *Markets and Hierarchies* (1975): Hierarchical systems can be superior for solving certain problems.
- Douglass North, *Institutions, Institutional Change and Economic Performance* (1991): Institutions exist due to the uncertainties involved in human interaction; they are the constraints devised to structure that interaction.
- Daron Acemoglu, James Robertson, *Why Nations Fail: The Origins of Power, Prosperity, and Poverty* (2013): The interplay of exclusive and inclusive economic and political institutions influences economic development and the associated prosperity in a society.

More of German Ordoliberalism?



Source: Own representation based on Eucken, Walter 1952/90: Principles of economic policy, 6th edition, Tübingen. XVI Chapter: The Constructive Principles, pp. 254–291 and XVII. Chapter: The Regulating Principles, pp. 291-304

Ingredience: Strategic Autonomy and Risk Management

- Strategic Autonomy: „In an increasingly competitive and uncertain international context, Europe cannot indefinitely outsource its security. Europeans should be able to carry out a broader range of tasks on their own, while working with the US and other allies and partners whenever possible. Strengthening solidarity within the EU and delivering tangible assets to cope with a wide range of threats are the twin tracks for progress towards a more strategic and autonomous Europe. [...] To achieve this goal, the EU should empower to carry out more demanding military tasks and engage with allies on a more equal footing” (Giovanni Grevi/ Paul Ivan, 2020).
- Risk Management: "Whether it is the financial crisis, terrorism or the threatening disintegration of the EU: We need an unsparing and comprehensive view of the risks in politics, the economy and nature in both states and companies. The claim that some crises could not have been foreseen is all too often ornithological horse-cheating." (N. vom Blomhard, 2016)

From “Pax Americana” to a New Bipolar World?!

- “The last decade of the twentieth century has witnessed a tectonic shift in world affairs. [...] The defeat and collapse of the Soviet Union was the final step in the rapid ascendance of a Western Hemisphere power, the United States, as the sole and, indeed, the first truly global power. [...] Eurasia, however, retains its geopolitical importance. Not only is its western periphery -- Europe -- still the location of much of the world's political and economic power, but its eastern region - Asia - has lately become a vital center of economic growth and rising political influence” (Zbigniew Brzezinski, *The Grand Chessboard. American Primacy and its Geostrategic Imperatives*, 1997).
- “The Western model of organizing international relations is based on freedom, sovereignty and equality. That is why Russia and China want to destroy it. But it is not as easy as they think. [...] Power is the precondition of international orders, but it is not their only currency. The character of orders is shaped by an interplay of power and ideas. [...] Russia and China fear nothing more than the virus of freedom, and they abhor the barriers imposed on them by the liberal order with its norms, institutions and treaties.” (Stephan Bierling/Gerlinde Groitl, *The Liberal Order and its Enemies*, 2022).

A Brief Comment

Prof. Dr. Jens Beckert





Round Table Discussion

Prof. Dr. Dominik H. Enste



Coffee Break



Impulse: “Reforming the Rules of the Euro Zone / Stability and Growth Pact.”

Prof. Dr. Lucio Baccaro



The Reform of Stability and Growth Pact

Lucio Baccaro

XI Conference IW-MPIfG

4 May 2022

Max Planck Institute
for the Study of Societies





Determinants of public debt sustainability

- > $r - g$ and ps (primary surplus)
- > 1974-1995: $r - g = 1.8\%$ (average 20 advanced countries)
 - Italy: $r - g = 1.1\%$
- > 1999-2019: $r - g = -0.25\%$ (average 20 advanced countries)
 - Euro10: $r - g = -0.01\%$
 - Italia: $r - g = +1.8\%$ (the highest of all!)





Is the Eurozone at Risk of a New Financial Crisis?

	1974-1995			1999-2019			
	g	i	r-g	g	i	r-g	ps
Australia	9.31%	11.41%	2.09%	5.37%	4.54%	-0.83%	
Austria	6.30%	8.22%	1.93%	3.29%	3.02%	-0.27%	0.72%
Belgio	6.60%	9.61%	3.01%	3.36%	3.17%	-0.19%	2.25%
Canada	7.95%	10.11%	2.16%	4.15%	3.42%	-0.73%	
Danimarca	7.46%	12.97%	5.52%	3.12%	2.89%	-0.23%	2.87%
Finlandia	8.80%	11.04%	2.24%	3.19%	2.93%	-0.26%	2.40%
Francia	8.25%	10.25%	1.99%	2.75%	3.01%	0.26%	-1.07%
Germania	5.95%	7.69%	1.74%	2.54%	2.70%	0.16%	1.17%
Giappone	6.43%	6.57%	0.14%	0.19%	1.02%	0.83%	-3.61%
Irlanda	11.18%	12.14%	0.96%	6.56%	3.86%	-2.70%	-1.35%
Italia	12.33%	13.42%	1.10%	2.12%	3.91%	1.79%	1.79%
Norvegia	8.63%	10.10%	1.47%	5.07%	3.65%	-1.41%	12.08%
Nuova Zelanda	9.91%	11.13%	1.22%	4.99%	4.94%	-0.05%	
Paesi Bassi	5.63%	8.41%	2.78%	3.36%	2.90%	-0.46%	0.61%
Portogallo	15.90%	16.64%	0.73%	3.03%	4.61%	1.58%	-1.35%
Regno Unito	10.00%	11.42%	1.42%	3.79%	3.34%	-0.45%	-1.31%
Spagna	11.88%	12.84%	0.96%	3.70%	3.71%	0.02%	-1.11%
Stati Uniti	7.32%	8.72%	1.40%	3.99%	3.52%	-0.46%	-1.75%
Svezia	8.67%	10.86%	2.19%	3.96%	2.94%	-1.02%	2.04%
Svizzera	4.32%	4.94%	0.62%	2.34%	1.70%	-0.63%	1.12%
Media Euro	9.28%	11.03%	1.74%	3.39%	3.38%	-0.01%	0.41%
Media No-Euro	8.00%	9.82%	1.82%	3.70%	3.20%	-0.50%	1.63%
Media Generale	8.64%	10.42%	1.78%	3.54%	3.29%	-0.25%	0.91%





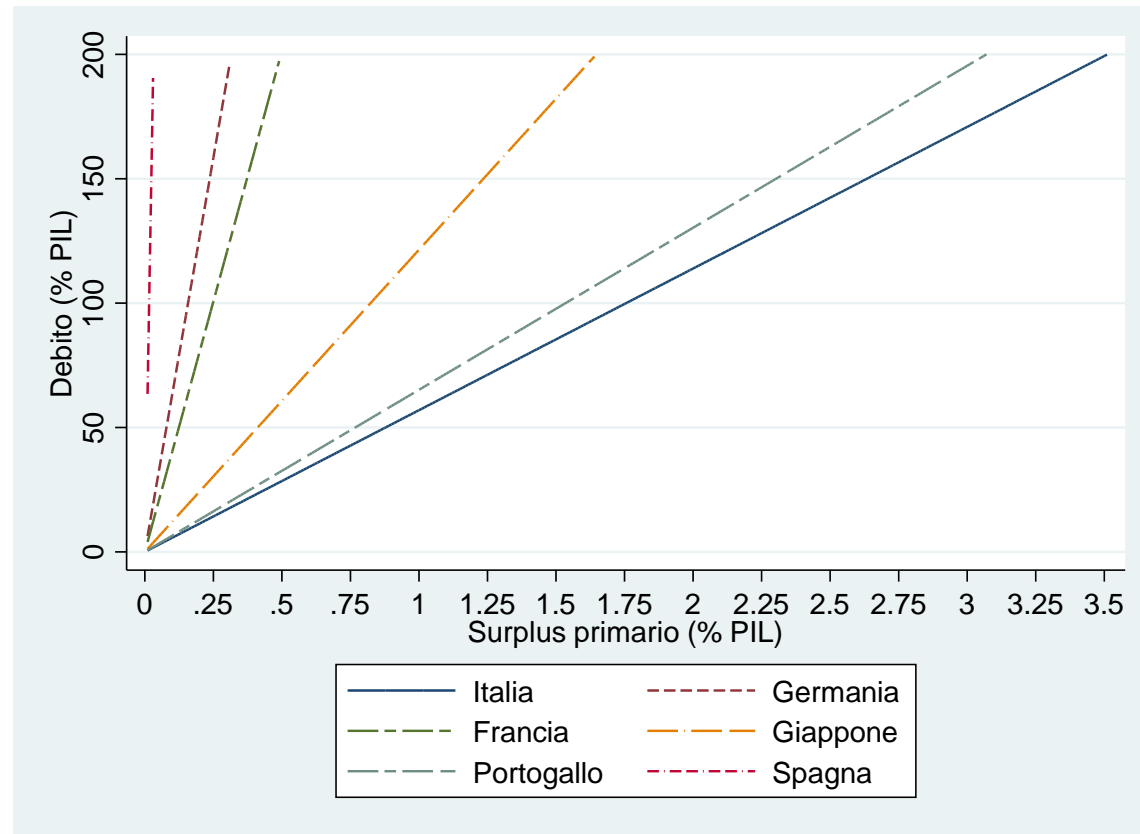
2021 public debt and primary surplus necessary to stabilize it

	Debito pubblico 2021 (% PIL, criterio di Maastricht)	pb*	pb(150)
Australia	.	.	-1.18%
Austria	83.05%	-0.22%	-0.40%
Belgio	111.74%	-0.21%	-0.28%
Canada	.	.	-1.05%
Danimarca	39.84%	-0.09%	-0.34%
Finlandia	77.37%	-0.19%	-0.37%
Francia	115.13%	0.29%	0.37%
Germania	72.84%	0.11%	0.24%
Irlanda	55.81%	-1.41%	-3.80%
Italia	154.58%	2.71%	2.63%
Giappone	.	.	1.24%
Paesi Bassi	57.60%	-0.26%	-0.67%
Nuova Zelanda	.	.	-0.07%
Norvegia	45.86%	-0.62%	-2.02%
Portogallo	133.39%	2.05%	2.30%
Spagna	120.12%	0.02%	0.02%
Svezia	36.77%	-0.36%	-1.47%
Svizzera	.	.	-0.93%
Regno Unito	103.50%	-0.45%	-0.65%
Stati Uniti	.	.	-0.67%





Relationship btw ps and debt given historical values of r and g





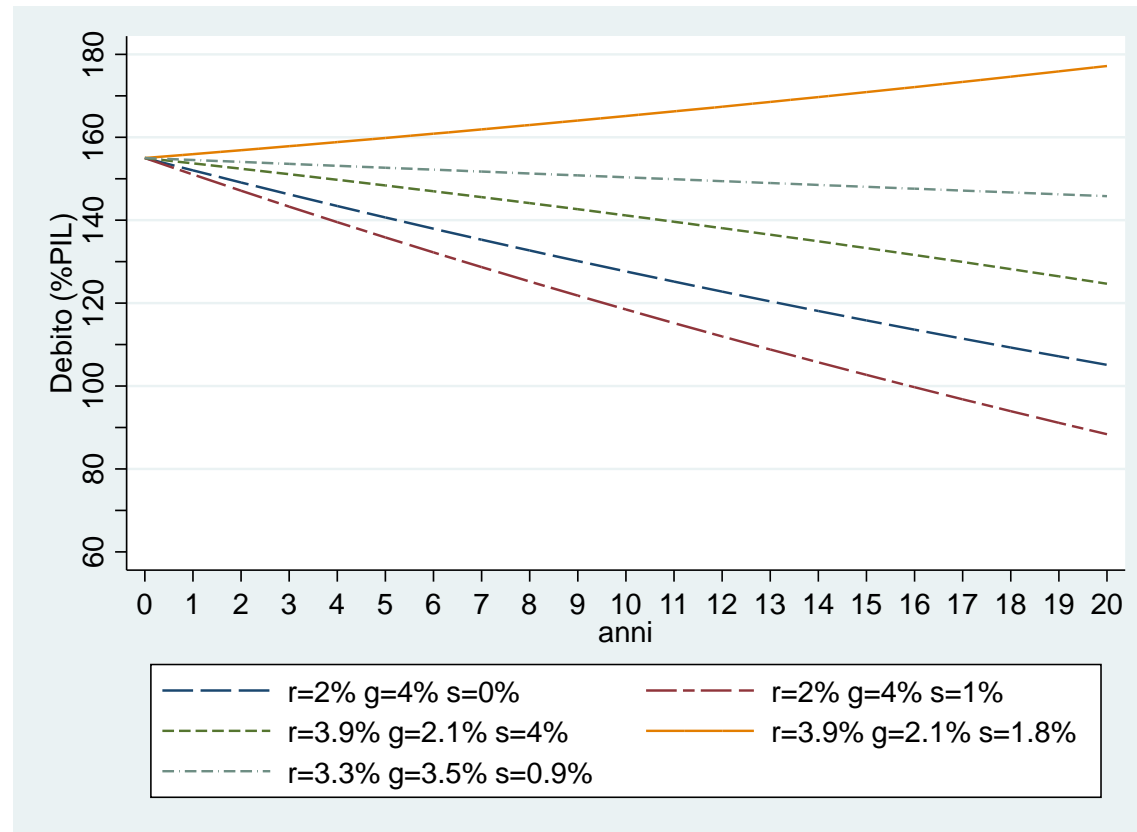
What needs to be done to boost public debt sustainability?

- > increase g
- > keep r under control
- > reduce as much as possible the primary surplus (lest g is affected) or increase the time period in which debt returns to the reference value (currently 60%)





Italy's public debt under different assumptions about r g and ps





Proposals under discussion

- > Golden rule
 - stimulates public investment

- > Increase in debt threshold (90-100%) and/or extension of adjustment period (beyond 20 yrs)
 - reduces the fiscal consolidation effort necessary to comply with the rule

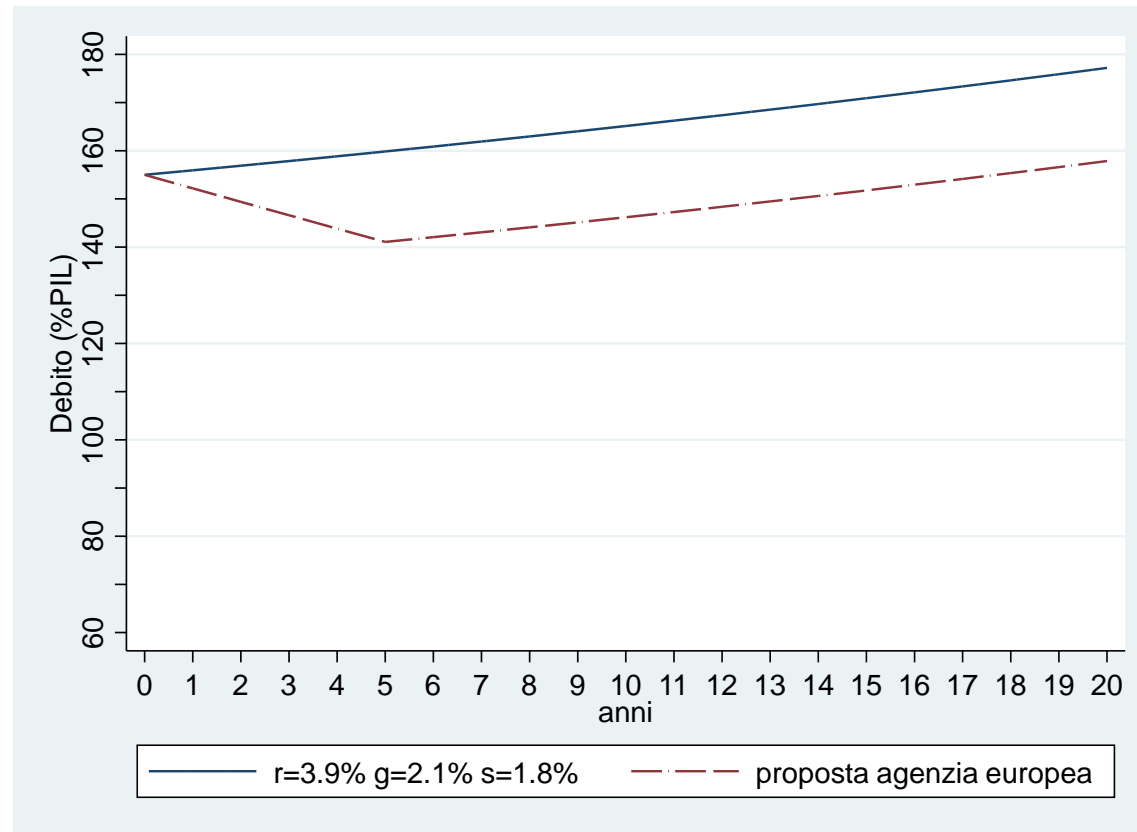
- > Expenditure rule
 - Reduces the role of unobservable entities, but in itself leads to an increase in the primary surplus over time (expenditures grow less rapidly than revenues)
 - Should be combined with a cap on the maximum primary surplus imposable

- > Debt agency
 - Positive for European construction, but only marginally reduces cost of debt service





Italy's debt after sale of pandemic debt to the EDA (Giavazzi et al 2022)





German Council of Economic Advisors' Proposals (2021)

- > Grimm & Wieland
 - expenditure rule + structural deficit target
 - debt ceiling: 60%
 - Application of the rules entrusted to an independent institution
 - (possibly): lengthening of the recovery period

- > Schnitzer & Truger
 - expenditure rule + golden rule
 - debt ceiling and adjustment path variable by country
 - do not throttle growth with premature fiscal consolidation

- > Additional proposal: Gern et al. 2020
 - No fiscal rules, no bailout, no QE
 - Transition period (10 yrs): targeting of spreads by ESM
 - After that, yields are solely determined by market confidence
 - Insolvency regime and orderly restructuring procedure





Questions to the audience

- > Are German policy-makers worried about a possible financial crisis?
- > Do they know that, unless things change, Italy's public debt is not sustainable?
- > Do they think there could be a break-up of the Eurozone? If so, what do they intend to do?
 - Stick to the rules: if one systemically important country exits that's no biggy
 - Relaxation of the rules about fiscal adjustment
 - How?





Thanks!



Comment: “Reform of the European Stability and Growth Pact”

Jürgen Matthes



Reform of the European Stability and Growth Pact

Comment on Prof. Dr. Lucio Baccaro



New times, new trade offs... - things don't get easier...

Strategic autonomy ever more important in these troubled times of „Zeitenwende“

- › BUT: Strategic economy requires stability and economic strength as preconditions
 - › A sovereign debt crisis / financial crisis would be even more catastrophic in current times
 - › EU would lose even more global significance and freedom to act to protect Europeans
- › But strategic autonomy (and Green Deal) are costly – reshoring, IPCEIs, green transformation
 - › Thus, strategic autonomy has implications for public debt sustainability (PDS)
 - › As have other megatrends of the current decade...

Effects of 4 current megatrends on public debt sustainability

	Public expenditure	Growth	Real interest rates
Demography	Higher social expenditure	Shrinking labour and skill supply	Savings in working age, potential dissavings in old age
Decarbonisation	Green Infrastructure and subsidies	Structural change (with unclear effect)	Higher investments
Digitisation	Digital public infrastructure	Higher productivity (but still Solow paradox))	Higher investments
De-Globalisation / Strategic autonomy / Industrial policy	Industry subsidies (e.g. IPCEIs) Stockpiling of critical goods	Lower productivity growth	Somewhat higher inflation (possibly)

Source: Matthes, 2022

Implications of the megatrends' influence on PDS

Inherent trade off between important EU goals (not sufficiently recognised)

- › Strategic autonomy, decarbonisation, digitisation vs. Public debt sustainability
 - › Especially in countries with high public debts
- › Optimisation required: maximise strategic/green goals while guaranteeing financial stability as collateral condition
 - › In other words: stability has to be prioritised, only if given, other goals can be focused on

Important implications follow:

- › Danger of overburdening the state
 - › Increasing demands on governments after Corona crisis - need to be reined in
- › Functioning SGP (ever more) needed to provide orientation and confidence to financial markets
 - › Doing away with the SGP (as some demand) would be highly counterproductive

Implications of the megatrends' influence on PDS

Investment in decarbonisation, reshoring, industrial subsidies not with guaranteed growth payoff

- › And: Higher investment potentially increases real interest rates during transformation
- › Assumption of self financing of public investment not on so solid ground (despite $r > g$)
- › **Requires caution with green/golden rules**, i.e. with generous SGP exemptions for public investment
 - › Exemptions could endanger PDS
 - › ... and would incentivise political circumvention strategies
 - › NGEU gives room for transformative public investment
 - › SGP gives already some flexibility for public investment (Co-financing, flexibility rule)

IW proposals for SGP reform

SGP reform needed contrary to what German government proposes

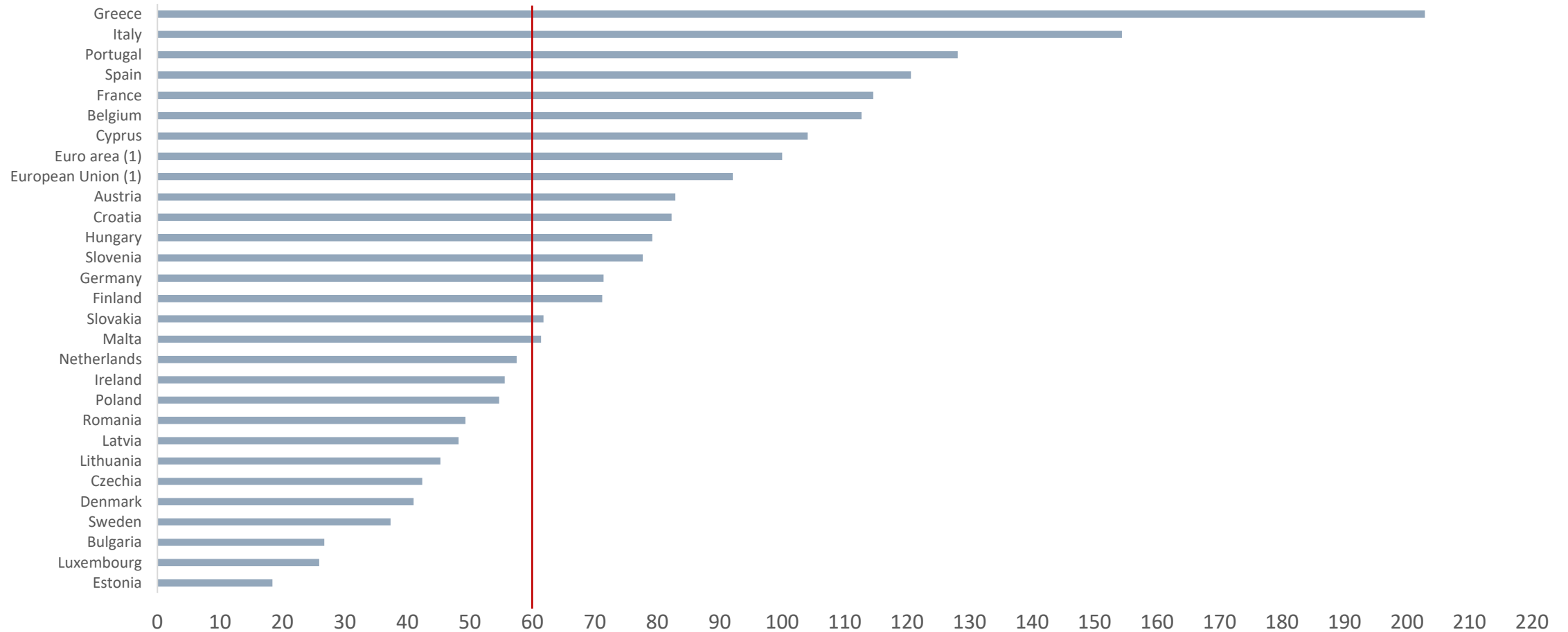
- › Because 1/20 debt reduction rule would overburden highly indebted countries

Public debt rules:

- › Keep 60 percent rule

Public debt in 2021 – 60 percent threshold not unreachable

Gross public debt in percent of GDP



Source: European Commission

IW proposals for SGP reform

SGP reform needed contrary to what German government proposes

- › Because 1/20 debt reduction rule would overburden highly indebted countries

Public debt rules:

- › Keep 60 percent rule
- › BUT: Change 1/20 debt reduction rule to prolong debt reduction path
- › Introduce individual medium term growth reduction targets based on specific PDS Analysis

Deficit rules

- › Keep 3 percent rule in corrective arm of SGP – due to signalling function
- › Deprioritise structural balance rule in preventive arm of SGP – due to lack of reliability
- › Introduce new medium term expenditure rule with expenditure ceilings

How not to use good times - common understanding needed

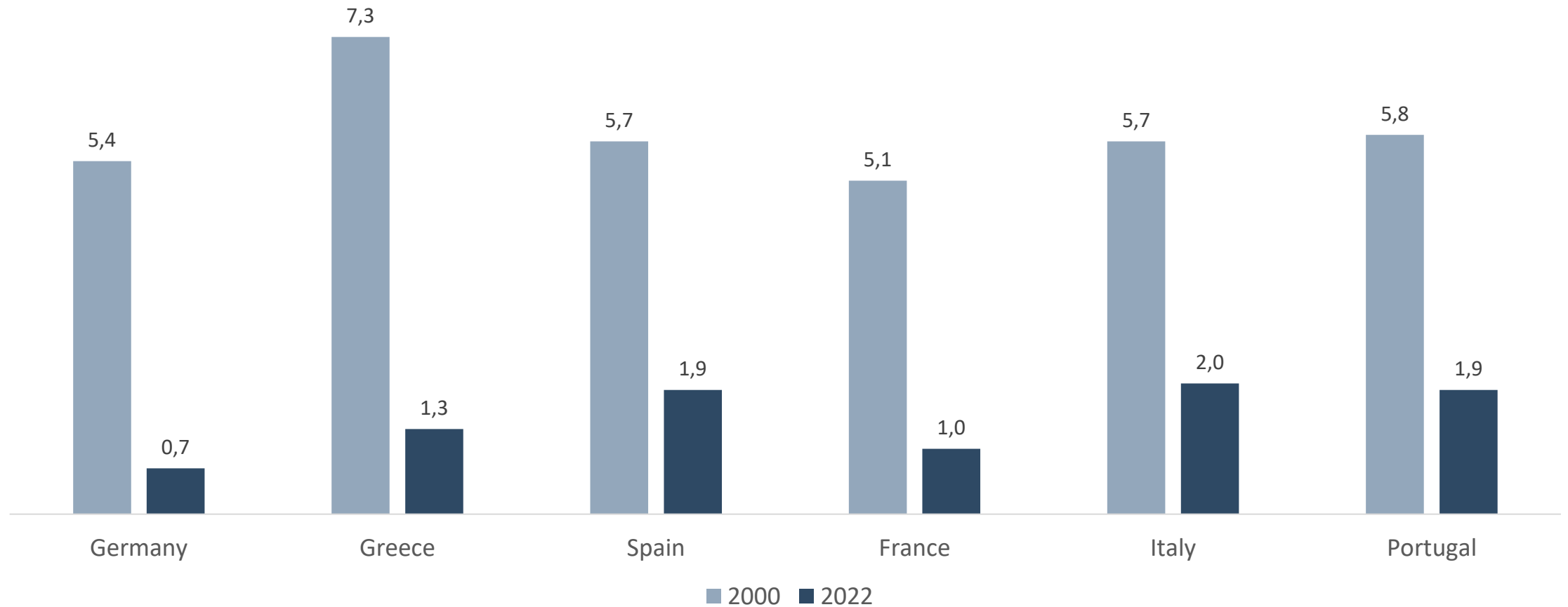
Primary structural balance in percent of GDP



Source: European Commission

Low average interest rates on public debts

Interest in percent of gross public debt

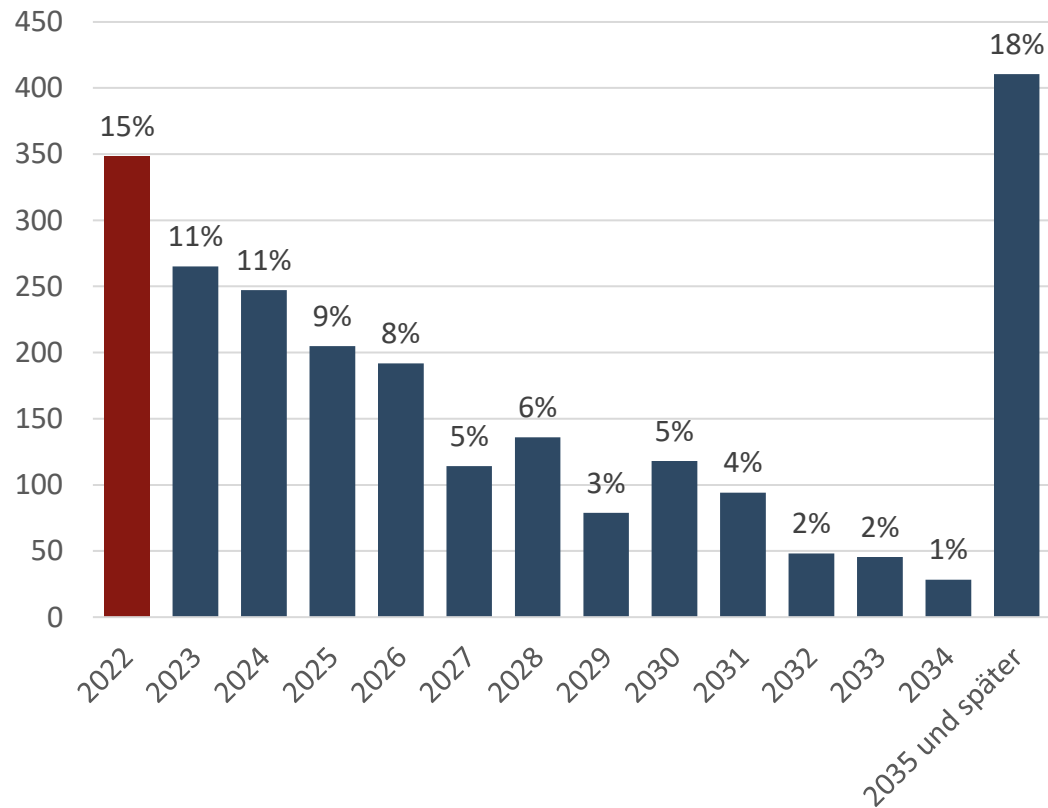


Source: European Commission

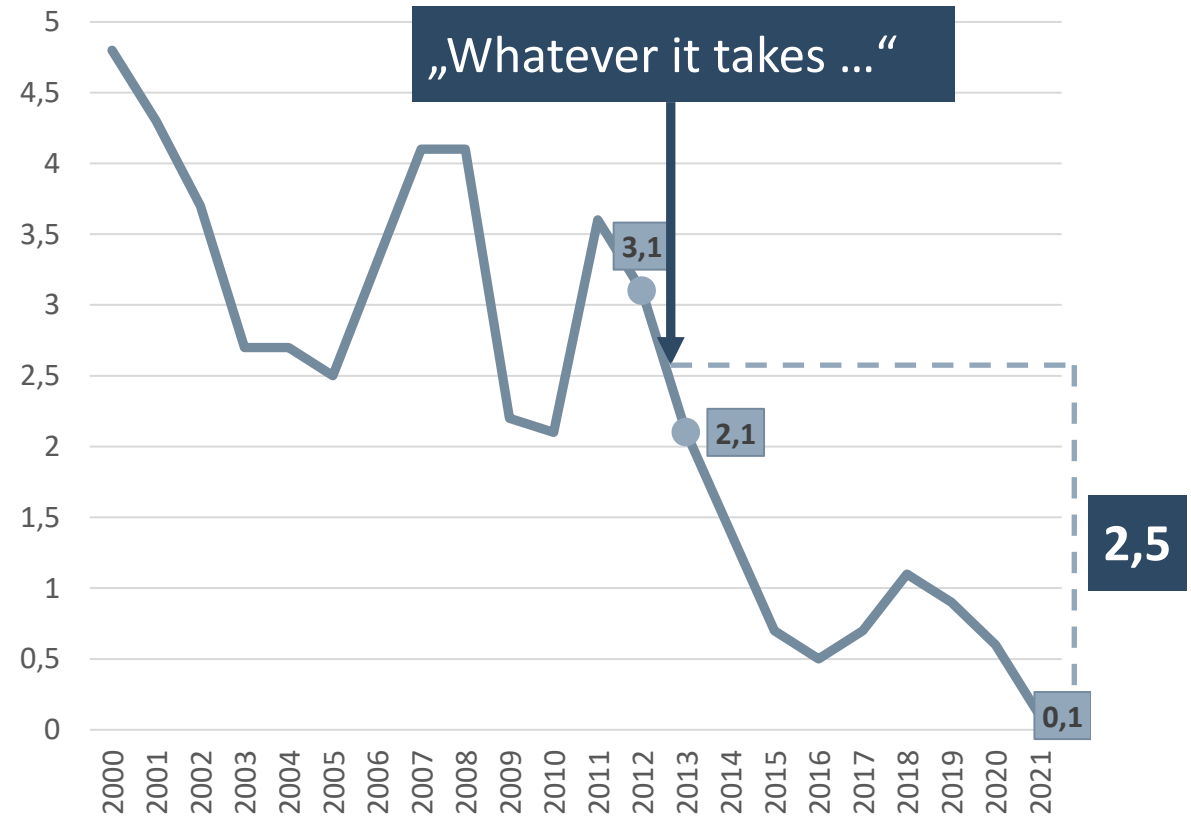
Low interest rates for longer on Italian public debts

Italy

Oustanding public debt, bn euro



Yield on emission in percent



Quelle: Ministero dell'Economia e delle Finanze