

# CARNEGIE COUNCIL *for Ethics in International Affairs*

## Is the Eurozone Crisis Over?

Public Affairs

Martin Wolf, Joanne J. Myers

### Transcript

#### Introduction

**JOANNE MYERS:** Good morning. I'm Joanne Myers, director of Public Affairs programs, and on behalf of the Carnegie Council, I would like to thank you all for joining us, including those sitting upstairs in the boardroom or those of you who are watching from your computer at home.

It is indeed a great pleasure to welcome Martin Wolf back to this podium. His reputation for being one of the most respected and incisive economic commentators of our time not only precedes him, but follows him wherever he goes. This following includes not only economists, investors, academics, but just about anyone and everyone who is interested in finances and the world. His [columns](#) in the *FT* are a must-read. If you are wondering why his writings are so eagerly anticipated, it's simply that he is one of the most judicious and informed economic journalists in the world.

Today his remarks will focus on the eurozone. The questions regarding Europe and the eurozone are many, but for our purposes today the immediate concern is whether the eurozone economy is on the mend. This also leads one to ask whether the euro system has been adequately reformed and whether the latest Greek bailout program will work.

In the summer of 2007, the glue of all financial systems began to dissolve, [devastating economies](#) worldwide. Few countries were left unscathed, but within the European Union some states were particularly badly hit, especially Greece. The [crisis in the eurozone](#) arguably reached its peak in 2010, when Greece faced [sovereign debt problems](#), calling into questions the stability of the eurozone single currency, the euro, its economic and monetary union, and, in the end, Europe itself, its values, and what it was trying to achieve.

With two bailouts and a third now on its way, Greeks will [go to the polls](#) on Sunday for the fourth time in three years. The goal: to get a government with a strong enough majority to enact the changes that Greece's creditors are demanding. The results will either strengthen the country's commitment to its bailout deal with Europe or will result in a fractious government that will struggle to carry out the demands of this latest rescue package. Either way, the vote will provide a moment of clarity not just for Greece, but for all of Europe.

With fresh fears over the state of the global economy and even some tears, our speaker, never one to cry wolf, will provide us with a well-balanced understanding of what's at stake and what we should be thinking about during these unsettling times. Please join me in welcoming one of the most distinguished international economists, our speaker Martin Wolf. Thank you so much for returning to this forum.

### Remarks

**MARTIN WOLF:** It's an immense pleasure to be back here. Whenever I come to New York, since my

[first speech](#) here, I always offer to come because it's always great fun for me, and since people are willing to—Joanne, above all, is willing to invite me again, I suppose at least some of you can bear it, too.

[Last time](#) I think I talked about my [new book](#). By now, of course, you have all read it. There will be a pop quiz to make sure that you have. However, if by any chance you have been so foolish as not to have bought it and read it, a paperback edition is going to appear in November, I'm told by my publisher, and it adds—this is relevant, actually—a new afterword, which is, in fact, a whole new chapter, including lots of new charts (I do like charts) about what has happened in the last couple of years and how that changes or modifies one's view of the [crisis](#), as Joanne says, the crisis, the financial upheaval, which we first noticed really in significant form more or less exactly eight years ago, slightly more than eight years ago—a long time. As I have been writing now again and again, in many contexts, we are still very much in its shadow. In fact, I call—and in this audience you will all know exactly what I am referring to—I actually call the last chapter of this afterword "[The Long Goodbye](#)." You all, of course, know the literary reference.

I have had an insanely busy week—really insane. So I found myself putting together what I was going to say today—I thought this was very modern—on Evernote, of course, on my smartphone, which is, I'm afraid, of a rather decrepit type, waiting, as one inevitably does, for a couple of hours in Reagan National Airport because the shuttle was late. That turned out to be very fruitful. So what you are going to get from me are the results of those ruminations.

Before I talk about the eurozone, which I will, I would just like to emphasize, because I think it's very, very important, that when we talk about Europe today, we are talking about the structure of the European Union as a whole in a time of what is very obviously profound upheaval in the region. It may well be that for those of us who have focused on the eurozone—and I'm going to mostly focus on that because I am an economist and that is what I have been thinking about now for many years—this may turn out to be less important, or at least no more important, than at least two other enormous issues—perhaps even three—that are now facing the European Union as a structure:

- First, the relations of Europe with contemporary Russia, and redefining or defining a stable order with Russia. I sometimes think of it as a stable frontier with Russia, where it ends and we begin, as it were. That's clearly contested, to put it mildly, at the moment. That continues to this day. Obviously, it is now focusing on [Ukraine](#), but that's not all that it's about.
- The second issue, which has actually turned out not just to be within the eurozone—I'll come to this in a moment—is, of course, who is going to be in Europe, in the EU. The most interesting question there, of course—made more interesting by the [selection](#) of Mr. [Jeremy Corbyn](#) as the leader of the [Labour Party](#)—is, where is Britain going to go? I regard it as a 50-50 proposition that Britain may leave the European Union within the next five years. Maybe I'm being a little too pessimistic—I tend in that direction—but I think there is a significant risk that Britain would leave the European Union. That will be obviously a very decisive decision for Britain, and I think it will be a really big change in the European Union—really, really big. There are a number countries that matter—certainly the most important by far, Germany—that will be really rather upset if this happens. How much price would they pay? Who knows?
- The third event, of course, can be talked about as our [migration crisis](#). It is pretty obvious that the European Union as an entity has completely lost control over its frontiers. It no longer controls the movement of people into it. I'm sure you have all been reading about what's going on in Croatia at the moment. Of course, that reflects the profound breakdown of political order—and it goes way beyond that—in the region that borders on Europe, namely the Mediterranean, the Eastern and Southern Mediterranean, with, above all, the [Syrian Civil War](#), the rise of [IS](#), [Islamic State of Iraq

and Syria/the Levant, ISIL, ISIS] Daesh, or whatever, and the [complete collapse](#) of political order in Libya, to much of which the West—and, I'm afraid, particularly the United States—made a very, very large [contribution](#), and with which we now live.

These events are enormously important, it seems to me, and are posing challenges for the extraordinarily cumbersome, complex, often dysfunctional processes of European decision-making, in the context of broader Western decision-making, to which they might well fail to rise. These are really profound strategic shifts, many of them surprising in their scale and urgency. Two or three years ago, I have to say, I expected neither the scale of the [breakdown](#) in the Middle East nor the extent of the conflict with Russia. This was really not on anyone's agenda. So one of the things I have learnt is that I never forecast, especially the future. [Laughter] But at least you can see it now, and it has raised many very big issues.

Having said that, let me talk briefly about the [eurozone crisis](#), and then in questions perhaps we can return to these issues and how they may relate to it, because the eurozone crisis is still very important. In the end, I tend to the view that in the modern world, certainly the modern West, if a society, if a country, an economy—I don't want to be too precise about these words—is not able to generate a satisfactory degree of prosperity and security in people's economic lives, it will become politically illegitimate and we are going to get, in different forms, protest movements of various kinds. Surely you can see that here at the moment. It's very obvious in what is happening in the [Republican primary process](#).

The European Union was founded on the idea that if we get prosperity—right back into the 1950s—if we rebuild the European economy, reintegrate the European economy, create prosperity, we will create the basis for a new European order. That was very much the idea. Economics was important in itself, but it was also the means to even bigger goals. It is very much the [Monnet](#) view of this process.

The creation of the currency union was part of that—or, you might say, the capstone of it. The idea was that this would further promote the prosperity of Europe, further promote the integration of the European economy, and would therefore cement the political achievements of the European project.

Now, I, as you probably all know, was a pretty typical British Anglo-Saxon, whatever, economist, and for about 25 years, I have held the view that this was an immensely risky proposition. A currency union is a different sort of thing from the trade integration, the single market program, that was introduced in the period from 1956 to 1986 with the [Single European Act](#). That was the sort of trade/market integration. But a currency union is a different sort of thing, demanding different degrees, and very substantially higher degrees, of institutional development, political integration, and popular support to sustain it through the difficult times that such a structure is likely to have.

For this reason, I was one of many people, though I wobbled a little on this, who very, very strongly supported—and I think I played quite a substantial role—I played a role; I don't want to overestimate it. I'm just a commentator—in persuading the British to stay out. This is history. I am absolutely convinced we were right to do so. I think it's pretty obvious now that we were right to do so.

By the way—this is relevant—my wobble, which occurred for six months in 1997, was I thought, well, maybe we're going to have to take this gamble and get in early and try and shape it, because if we don't, sooner or later we are going to become semi-detached, and when we become semi-detached, in the end we will become detached. And that is indeed what has happened. But I don't regret my subsequent, six-months-later decision that this is just hopeless.

As I always say to everyone in the continent, "You're very fortunate the British were not in it, because if we had been, we would have broken it up." There is no way, I think you can safely say, that Germany would have been able to dictate to a British government as it has done to Spain or Greece. We would

have gone, and that would have shattered the system.

So that is a preamble. I will just cover the main points about the crisis.

When the crisis hit, it was very much as I feared, but much worse. It was much worse because it happened, as I suppose one should have expected, in the context of a global financial crisis and a global panic, as you know. If you look at the eurozone data very carefully—and I'm sure I have made this point to you before—essentially you can see very clearly in the data on output for the GDP and unemployment that the eurozone, as a result, essentially had two crises, while you, for example, and the UK essentially had one.

First, the eurozone was hit by the global crisis. There was a huge recession, just as there was in every other developed country, in 2009. It hit different countries to different degrees, but everybody had a huge reduction in GDP.

Unemployment generally rose very considerably. Where it didn't, part-time work grew a lot, as in Germany. They promoted this. So that was where they were in 2010, and it looked as though it was stabilizing.

Then, as Joanne said, you then had another wave of crises, which was the eurozone crisis narrowly defined, which hit three countries that then went into IMF [International Monetary Fund] programs, [Greece](#), [Ireland](#), and [Portugal](#), and two other very important countries, [Spain](#) and [Italy](#), that never went into programs, mainly because nobody could afford them. There was never a possibility that that could happen.

These five countries together account for very nearly 40 percent of eurozone GDP, and they suffered colossal crises, which it took a very long time to get control over. The result is, if we look now—I'm going to start with where we are now—output is finally beginning to recover at the eurozone level. It's true. It's growing in the sort of 1 to 2 percent range. We don't know where it will end up yet this year, but it's something in that range. But today, the very last figures, eurozone GDP as a whole is still, significantly, about 1.5 percent lower than it was in the first quarter of 2008. This is seven and a half years later. There has been no aggregate growth at all. That's true for the eurozone. Just to compare it with the United States, the United States is up about, I think, 9 percent. A very, very big divergence.

In the crisis-hit countries, they are recovering to differing degrees, but they all have still GDP well below the pre-crisis levels. I'll come back to that in a second.

In the case of the eurozone, one other very important piece of macro data, which explains a lot about how the crisis has been handled, from an aggregate point of view: Real demand in the eurozone fell much more than output, basically about two or three percentage points, cumulatively over this period, more than output. The difference, of course, is what has happened to the external accounts of the eurozone. The eurozone as a whole has moved from having a modest external deficit, a current account deficit of 1 percent of GDP, to having a current account surplus now of about 3 percent of GDP. So it's a swing of about 4 percent of GDP. In aggregate terms, it is now the biggest surplus in the world.

It is very, very important to understand this because it is the central part of the way the crisis from a macroeconomic point of view has been handled, the emergence of a German eurozone. The relevance of this—and it is very important for the world as a whole—is that Germany now has a current account surplus of 8 percent of GDP, which is quite staggering. Throughout the last 15 years, the growth of domestic demand in Germany has been very weak, and German output has been sustained—it was dramatically true before the crisis, but it has been true to a much smaller extent since, but still modestly true—by a growing external surplus.

What happened when the crisis hit—and this was the big event—was that domestic demand in all the crisis-hit countries collapsed. The figures here are often not used, so this is something that many people won't know. In Greece—we talk about the recession—GDP fell by 25 percent. Real domestic spending in Greece—that is to say, which determines your living standard; it's what you buy as a country—fell by nearly 40 percent. This is one of the biggest collapses in an economy I have any idea of. But even in Spain, interestingly, which is now coming out of it, relatively, it fell 20 percent. GDP only fell 10 percent, because Spain eliminated an enormous current account deficit which they had before the crisis and it now moved to surplus.

Essentially, all the crisis-hit countries could no longer borrow. The financial process broke down. This transfer of resources to them ceased, and the current account deficits that used to offset the huge German and Dutch surpluses dominantly all disappeared and they all moved into surplus. Now we have a situation, interestingly, in which in the eurozone there is only one country which has any current account deficit at all, and it's very small, and that is France. Everyone else is either in balance or significant surplus.

Which is just to say—this is the core point I'm making here—the eurozone adjustment process is a large negative shock for the rest of the world. It is one of the reasons, in my view, that the emerging economies are in trouble, because, of course, somebody else had to bear the counterpart adjustment. It wasn't the United States in this case. It was partly China, but it was also many other emerging economies. It's one of the reasons, I think, for their fragility.

So that is the global context. Now let me just talk very briefly about what has happened to the different countries. I have already told you about the declines in real demand, which were very similar in the crisis-hit countries. In Italy it was smaller because they had a much smaller external deficit than Spain. But basically where we are now is that in Italy GDP is roughly 10 percent below the pre-crisis level. In Spain it is now about 7. They are very, very slowly recovering. In Portugal it is about 6 or 7, in Ireland it is now about 5, and in Greece it is now still way over 20. They are all vastly poorer than they were before the crisis. In GDP-per-head terms, it's worse. Unemployment rates in Greece are still, of course, close to 30 percent; in Spain it is still way over 20; and in the other countries it is in the teens.

My estimate is that the most successful countries might get back to pre-crisis GDP per head and pre-crisis unemployment rates sometime around 2020. It varies for the different countries. We can go through them. But essentially it is more than a lost decade. It is well over a lost decade. As a consequence of this, in many countries a large proportion of able and educated young people have emigrated. That is a very important part of the adjustment mechanism, which many people are very worried about because, of course, these are the people on whom the longer-term future rests.

Greece in this context is *sui generis* (unique), both in the scale of the recession, which I have described, and the political consequences thereof. As was already mentioned, it is the only country which is still in a program or is going to be in a new program. The political uncertainty remains very high. We don't know what the new government is going to look like. But I tend to think now that the desire of the Greek people to stay in is so strong that it is going to continue.

So the key point I want to make on where we are is it has been an unbelievably costly crisis in aggregate. A lot of the adjustment has been externalized. But inside the eurozone, the crisis-hit countries suffered colossal recessions. They are beginning to recover—not really in Greece, but in the other countries—but it is going to end up as worse than a lost decade. That's the story. High unemployment remains significant, and for that reason, emigration is also significant.

The longer-run political consequences, I think, will be severe. One of the things that I have become increasingly aware of—I can see this in Britain now—is that the long-run political consequences of large economic shocks come through quite slowly, as people begin to realize this isn't just a little blip;

this is a fundamentally different world from the one we thought.

What are the problems they have now? Where are they now? One, we have a vulnerable recovery, as I have indicated. But because of the policy settings in the eurozone today and, above all, the extreme dependence on central bank financing, radical central bank financing, in QE [quantitative easing], with ultra-low interest rates, they have next to no ability to respond to any new shocks. There is no capacity to respond to large negative shocks.

There has been a severe loss of public trust. At the core of the eurozone, as I have indicated, with its colossal German surplus, the most creditworthy country in the eurozone has very, very weak domestic demand, so demand growth depends on the external world, depends very heavily on what happens elsewhere. The UK is actually the eurozone's most important trading partner. The United States, China—all this matters very much.

The two other real vulnerabilities are:

- Debt, both private and public—not both; either private or public or both—has risen in every country, so they are much more heavily leveraged than they were before.
- Underlying trend growth in all countries is pretty low. Very few countries have trend growth above 2 percent. Spain might; no one else does. In Italy it looks close to zero. That makes management of debt very difficult, and there is a real risk of reemergence of imbalances.

So there is a recovery, a cyclical recovery, but it leaves huge structural weaknesses, which have very profound political effects.

Let me just finally conclude by thinking about the future. I have already mentioned the pressure from these external events, these three external—well, in the U.K. case, internal pressure—but let's think a little bit more about where it might go.

I think the most interesting question here is how far the eurozone has created a set of institutions and institutional arrangements as a result of the crisis which will allow it to handle future shocks better than they have this time. That is obviously immensely important, either to avoid them, avoid the sort of mess that occurred, or to handle them better next time.

The basic story, I think, of how this was handled is what I call the emergence of a stronger disciplined union—namely, tougher rules on the way individual countries behave—designed to prevent the emergence of these sorts of imbalances in the first place, combined with a much more aggressive, much more positive central bank than anyone imagined could emerge in the eurozone context. The ECB [European Central Bank] under [Mario Draghi](#) has really ceased to be the Bundesbank. That is really quite important, and I think that is the only reason they got through this at all. If it hadn't been for the ECB in 2012 with its outright monetary transactions, the "whatever it takes" program, and the QE, I think they would now be in really, really desperate trouble. That is basically what they have got.

What they have failed to provide—that is the first really big failure; it follows from what I said—is a system that generates, to a degree automatically, either through economic or other processes—it could be a mixture of endogenous economic processes and policy change—what I call an adjustment union. Adjustment on the macroeconomic side has been externalized. Demand has been shifted from internal to the rest of the world.

The third thing that they could have done and that they made a bit of a move towards is what I call a private insurance union. What I mean by this is that it is a logic of the eurozone as an entity that it would have an integration of the financial sector and the capital markets such that if one part of the



place got into trouble, the risks were quite widely shared among the population as a whole through the financial sector. If, for example—just to give you one example—most of the capital flows inside the eurozone had occurred through equity rather than debt, then automatically when Spain had a huge crisis, there would be capital losses in the equity markets. You don't have a fixed claim. The claim automatically adjusts to the value of the assets on which you have a claim. This is, if you like, the best form of a private insurance union. It's a risk-sharing process.

Similarly, with debt you could imagine, instead of conventional government bonds, you have GDP-linked bonds, something which adjusts automatically when there is a recession.

In the beginning of this crisis, there were next to no such private insurance arrangements in the system. I can't go into the detail, but everything ended up in the debt markets, bubble banks with central, and, of course, as soon as that happened, the banks started looking terribly vulnerable.

Obviously, a big question is, has that changed? I would say it has changed very little. We still don't have a eurozone-integrated banking system in any way, and very little of the capital flow even now comes via equities.

The fourth possibility is that they would really increase the degree of public insurance, fiscal mechanisms of the type you are all familiar with in the United States, automatic fiscal mechanisms which compensate people for huge recessions. Essentially nothing of this kind has occurred at all—next to nothing. There is tremendous resistance. No signs so far of willingness, above all in the creditworthy nations, to create a genuine fiscal union. That seems to be off the table.

What we've got is, I think, a stronger set of institutions than before, but very far from what we would think are likely to allow the eurozone to cope with the next crisis very much better than last time. I think a little better, but not very much better.

My concerns about the long-run stability of the eurozone remain, particularly in the context of the sorts of pressures we have seen before. So what I would say is cyclical recovery. They got through the crisis so far, more or less, largely because of the central bank and a tremendous willingness to bear pain. But this has not yet been reformed sufficiently for me at least to feel confident that it can cope with the next shocks, whatever they are, vastly better than it did last time. That's worrying because the eurozone is today still the second-largest economy in the world just after the United States, bigger than China, although obviously that might not continue forever, and it is an enormously important player in the world economy, the eurozone taken as a whole, and, of course, in the West.

So those are my introductory remarks. I am very happy to take any questions. Thank you.

## Questions

**QUESTION:** James Starkman.

First of all, as a commander of the British Empire, I want to congratulate you on your triumphant victory at [Trafalgar](#). It really was impressive.

What are the talking points of Labour in the move to possibly withdraw from the European Union? It would seem to me that Great Britain is getting many of the benefits of membership. There doesn't seem to be the threat of an undermining of their sovereignty. There would be some sharing in any future crisis. But I was wondering what your take is on that.

**MARTIN WOLF:** This is a very interesting question, because obviously we have a completely new constellation of forces in the Labour Party now. You were talking about the Labour Party, yes?

By the way, I should say that whenever I am introduced in the United States—I don't think you did it—and it is pointed out that I'm a commander of the British Empire, I like to say it shows that whatever the British have lost in the last century, they haven't lost their sense of humor. [Laughter]

The interesting thing about the [Order of the British Empire](#) is that it was introduced in the [First World War](#) in order to recognize the heroism of ordinary people. It was the first major civilian order. Prior to that they were essentially all bureaucratic or military. It's interesting when you think about it because the First World War really was the point at which it became obvious that the British Empire was not sustainable.

I also like to say—though I'm not so sure about this anymore, given what is going on—that we will probably continue to make people commanders and knights of the British Empire long after everybody has forgotten there ever was a British Empire. But then, we haven't forgotten the Roman Empire, so maybe we will go on.

Labour, two or three points. Very interesting. One of the things I find most fascinating—it is because I am old enough to remember this, and I have been interested in this since the 1950s, because my father, who was an immigrant refugee from Austria, was very interested in the future of Europe, for pretty obvious reasons; we talked about it in the 1950s—is that the British parties' view of Europe has changed in fascinating ways over the succeeding 60 years, while the European Union hasn't really changed very much.

In the beginning, the Labour Party view of the European Union as it evolved in the 1960s is that this was a capitalist plot. Free competition. It had, very strongly, the post-war German principles base in it, along with, of course, the French ones. It's a strange compromised structure intellectually and institutionally. But we thought it was a capitalist plot. Increasingly, the [Conservatives](#) came to the view that actually it was a great pro-market institution. Therefore, in the 1960s the Conservatives wanted to join and the Labour Party wanted to stay out. That was basically the situation.

I won't go into the 1950s. In the 1950s nobody wanted to go in because we thought the Europeans were unimportant and had failed and we were a great power. But we got over that, pretty clearly. That's why we created EFTA [European Free Trade Association] in the 1950s. We couldn't bear the idea of becoming part of this structure. That was pretty stupid, as it turned out.

[Edward Heath](#) negotiated entry, Conservative prime minister. The Labour Party was very unhappy about it. This is very relevant to what might happen. [Harold Wilson](#), who was a shrewd and devious person, decided he would have to solve this problem in the Labour Party by having a national [referendum](#), which he did in 1975, which he won. Namely, we voted to stay in. But the Labour Party ultimately split over this issue. It took a long time, but that referendum created such turmoil inside the Labour Party between the people who wanted to stay in and the people who wanted to leave that some of the most passionate proponents of full membership, one of the most important being [Roy Jenkins](#)—he was a very significant figure in British post-war political life, president of the commission later. Actually, he really started the European monetary system, or was one of the players in that.

It split the Labour Party.

Then, in the course of the 1980s, we got [Thatcherism](#), and the Tories decided, actually, it was a socialist plot; the European Union is wildly left-wing, full of [dirigistes](#), while we were, of course, on our march to the heaven of absolute free markets, and this was a socialist plot. As it became seen more and more as a socialist plot, the Labour Party decided they really liked it.

This is not a joke. This is what has happened.



So by the early 1990s, when we had the [Maastricht Treaty](#), the Labour Party was fully and completely beside the European Union, which it thought was the only bulwark left to protect us from wild, mad Thatcherism. The Conservatives decided—many, many Conservatives—increasingly, that it was a plot to destroy our sovereignty and a plot to destroy our economy. That's why poor [John Major](#) had this terrible nightmare getting the Maastricht Treaty through. It split his party, and it was one of the many reasons they got rejected in 1997.

Then we got this wildly pro-European prime minister, certainly the most pro-European after Heath, [Tony Blair](#), who would have taken us into the monetary union in a heartbeat. I have talked to him many times about this. Thank heavens, the only really important contribution [Gordon Brown](#) has made to the life of our country—but it was very, very important—is that he kept us out. He alone kept us out. I think this is not widely understood. Blair would have gone in whatever.

I know this is long, but it's quite important to finish the picture of Britain.

Now where are we? Well, nothing much has changed, except Labour is more left than it was before. That's obvious. Why is it more left? Because of the crisis. I have just written a column which will appear very soon about this. We have gone [Bernie Sandersish](#), as it were, in your context. We think capitalism has failed on the left. The Tories think even more strongly that they are a bunch of socialists. Now we are in the situation where a lot of important Labour people and a lot of important Conservative people agree on one thing: This is a plot. But whether it's a market plot or a socialist plot, they are not sure. That they disagree on.

This is new. That's why it is so difficult to win the referendum. This is relevant to what is going to happen now, I think. Jeremy Corbyn has just written a [column](#) for us—an editorial, I think you would call it—which you should read, in which he says, "We are going to support membership. We will stay in." That was new. It wasn't clear a week ago. "But," he said, "we want to go in in order to turn the European Union into a proper socialist system." He was very clear about this.

[Cameron](#), of course, is going to negotiate these terms. The terms he wants are that we should be allowed to do whatever we want with our labor market and the city must at all costs be protected. Those are precisely the two things Mr. Corbyn does not want to happen. The more successful Cameron is in getting what he wants—he probably won't be very successful—the more the Labour Party is going to be split on supporting it. Even if Corbyn comes out in favor, an enormous number of people in the Labour Party will oppose it. Because now we all dislike the European Union. Because we dislike it for opposite reasons, one side of Britain wants to change it in one direction, the other side wants to change it in the opposite direction. And by the way, of course, they are going to fail. That goes without saying. A country that is a tenth of the European population is not going to transform it, even if it is quite a large country.

I tend to think now this is a high-risk referendum. Everybody is going to be at cross-purposes. A huge number of people are going to hate the terms on which the deal is proposed, and it is going to become very, very difficult to manage.

And in a one-off referendum, as we saw in the [Scottish referendum](#)—which, by the way, when we started, everybody assumed the no vote, the stay-in-the-union vote, as it were, would win overwhelmingly. That's not what happened. I think once this starts, all the antis will be fanatical, the pros will be put forward, pragmatic, not very principled—nobody, really, in Britain really is passionately committed to this. Tony Blair is the last great pro-European. So it will be passionate people on both sides opposing a lukewarm center, and I think in a one-off referendum anything can happen.

That's basically how I see this fascinating episode. I think the referendum is a grossly irresponsible piece of nonsense. But there we are. That's where we are.

That was a disgracefully long answer.

**QUESTION:** Ron Berenbeim.

Can you comment on how these economic developments that you canvassed very well have contributed, if at all, to greater income inequality and what impact that might have, along with the migration crisis, on the internal politics of some individual countries.

**MARTIN WOLF:** The data on income inequality within European countries is not updated very frequently and I think of somewhat variable quality. I haven't seen good data—I'm not saying it doesn't exist, because I haven't looked at every estimate—on the changes in the last four or five years.

My assumption would be that in the crisis-hit countries, almost by definition, in any meaningful way, it has clearly gotten worse. Just having vast numbers of people without a job, even with a welfare state, clearly their incomes have fallen a lot. If you are talking about income distribution, I think it has pretty clearly gotten more unequal.

Wealth is much more complicated. That's why I was thinking about this, because it is what [Piketty](#) is [focused on](#). Of course, there have been very large asset valuation falls, particularly in the property market in some countries. Think of the Spanish property market, for example. Ditto the Italian, though to a lesser degree. So what has happened to wealth distribution is not clear.

So on the income distribution, I'm sure it has gotten worse, but I haven't seen detailed figures, and on wealth, it must be a very complicated picture. But I tend to think that in the short run—and we are talking economic short, not financial short; financial short run, I know, is a minute, but to me, economic short run is a year or two or three—the really dominant factors, I think, are the aggregate reductions in real income per head, which have varied—in Greece the aggregate reduction is about 25 percent; in the other countries it is varied, about 10 percent, 12 percent, something like that—and even more important, these huge rises in youth unemployment rates, in the 50 percent range for Spain and Greece.

Those are, I think, the dominant things.

If you look at the longer-term data, by the way, for Europe, it is very, very interesting. There are some very good studies of this. Most countries in Europe have experienced rising inequality of household incomes, above all pre-tax, a little less post-tax. Don't forget, we do a lot of redistribution, more than the United States. Most European countries do. But the degree to that varies a great deal across countries. It is not universal. There is no country in Europe, even the UK, where it has been as big as here. The United States is an outlier on the data.

The OECD [Organisation for Economic Co-operation and Development] data are very clear. OECD puts together—you can go and look it up—very specific data on income distribution. In France, interestingly and fascinatingly, over the last 30 years the income distribution, on the measures that we have, has actually gotten more equal, both pre- and post-tax. Of course, that is partly because—it's interesting. France used to be rather unequal. It has now swapped over. Britain got radically unequal under [Thatcher](#), but it stopped getting worse after 1990.

These differences in national trends across the OECD are a fascinating puzzle. I don't think I have time to go into trying to work out why they happen. But the U.S. story—in the sheer scale of increases in inequality of pre-tax income, above all, in the United States for households and individuals as well, it does seem to be quite an extreme outlier among the OECD countries.

**QUESTION:** Don Simmons.

I just finished watching most of the [Republican debate](#) a couple of nights ago, and apart from some brief expressions of a desire to reduce taxes, there really was not much discussion of macroeconomic problems facing our country. I'm just wondering what you think are the United States' central macroeconomic problems, and are they of a similar scale to those of Europe?

**MARTIN WOLF:** Since I'm a foreigner and it is always appropriate for a foreigner to be polite in public in another country—and I follow this rule—I'm not going to comment on the quality of economic debate in the Republican Party at the moment, except to say there is very little evidence that reductions of marginal tax rates from levels currently in the United States have any significant impact on the aggregate performance of economies. There really isn't. There has been a lot of work on this.

One of the main problems in the United States—let's leave aside completely, though it is colossal, the whole income-distribution type question simply because of lack of time. I would focus on three things:

- First, what [Larry Summers](#) calls the secular stagnation problem, which is, I think, a global one—it is a core part of my book—which is the simple fact that investment demand in our economies in the private sector seems to be chronically and structurally weak. That creates an environment in which, as he argues and I argue as a central part of my book, the only way we seem to be able to generate sustained rapid growth in demand in our economies is via inherently unsustainable credit problems. That is a really bad place to be, and I think that is very clearly where the United States is, which is why your interest rates remain so weirdly low and, in my view, are going to remain weirdly low. I'm not saying they won't go up to above zero or a quarter point at some point, but it is worth remembering—and I make this point every time—that in the developed world—and the United States is part of this, of course—our monetary policies and monetary settings are ones that in any previous time we would have assumed would generate hyperinflation in two years. We have what I call chronic demand deficiency syndrome in extreme form. That basically reflects a fundamental weakness in investment.
- The second problem, which I hadn't realized before—I have been realizing it, but I have only really got the most amazing figures for yesterday from a visit to the Council of Economic Advisers—is U.S. employment. I wonder how many of you know—maybe you all do know—that today the participation rate, the proportion of the population of what is normally called prime age, people between the ages of 25 and 55—so the people you always think should be working; they are involved in parenting and so forth—in the United States not only has been on a secular decline for the last 30 years, it is now the same level as Italy's and lower than France, Germany, the UK—all the obvious comparator countries. So instead of being a high-employment economy, this has become a low-employment economy, for men. For women, it has gone up, but in the case of women over the last 50 years—again I didn't know this—it has been stagnant and it is now below that of many European countries which have continued to rise.

So quite apart from the income distribution side—these are data from the Council of Economic Advisers—the wage side, there is clearly a fundamental employment problem. These are participation rates, people looking for jobs. If you look at the proportion of the population actually in employment, you get similar declines. That is not all generated just by aging. It is clearly not all generated just by aging. There is a real jobs thing going on here. I discussed this there. The truth is, we don't really understand why that is happening. That seems to me an absolutely gigantic problem for the United States.

- The third thing I would emphasize—and I have been involved in this debate—you, like all the other developed countries—you are not unique; in some ways, much the same—are also experiencing—and I believe this is not a statistical mistake; it's a genuine fact—a marked and very worrying slowdown in productivity growth. This is a controversial issue, because some people say

that we are missing the real GDP. I am absolutely convinced this is not the case, but we are discussing it. Of course, in the long run, the standard of living of a society, of a modern economy, depends, above all—productivity is not everything, but it's almost everything, as [Paul Krugman](#) has said. And it is.

So those are, to me, the three big things that one would worry about, apart from income distribution, which is, I think, very closely related to all three, by the way: the weakness of demand, the employment problem and the weakness of demand for labor towards the bottom end of the skill distribution, for a whole host of reasons, and the productivity slowdown.

What I think will be useful in the political debate—and I give [Hillary Clinton](#) some credit for at least raising some of these issues—is if people even recognized that these were real long-run, structural problems, and the U.S. economy is not working very well.

I should stress, by the way, though I have made some comparisons which look more favorable in some ways for Europeans, to a greater or lesser extent we all in the developed world are suffering similar sorts of problems.

**QUESTION:** Rita Hauser.

I want to come back to England and Europe. While Britain has stayed in the European Union, it has opted out from a lot of things, particularly the [Schengen Agreement](#). Initially when this refugee crisis began, Cameron took his position, "We're not obligated," blah, blah, blah. [Merkel](#) called into question the fundamental values, human values, that underlie the European experiment. I think with that and some shame factor that emerged in England, reluctantly Britain will take in some more migrants. How many I don't know. I don't know how many we will take in—

**MARTIN WOLF:** Twenty thousand. The promise was 20,000.

**QUESTIONER:** I think the number will probably go up, as it will here.

But how will Britain deal with this in the context of the economic situation, taking in more migrants, many of whom—the vast majority—are Muslim? How will this affect the politics and discussion of the referendum that you were talking about?

**MARTIN WOLF:** I think this fits in very well with where I started, the migration challenge. I think it is a fundamental question. Let me comment as follows.

First, it is absolutely clear that a large part of the hostility to the European Union that has emerged in the last 13, 14 years, 15 years, is related to immigration. The British government under Tony Blair made a brave decision, whose implications they didn't understand—which is perfectly reasonable because nobody did—that when the accession countries of Central and Eastern Europe joined the EU, we, unlike other major countries, particularly France and Germany, would have no restrictions on immigration into our country. That led to a much larger immigration from Central and Eastern Europe than anyone had expected. I can't remember the exact figures and I apologize if they aren't right, but I think, for instance, there were close to about half a million Poles alone—obviously the biggest country. Somebody can correct me on that, but I think it is that sort of number.

Personally, I think this has been an unambiguous economic and social success. But many people—they did introduce real competition for lots of people, particularly, interestingly, in the construction business. They were very highly resented. There is no doubt that the rise of [UKIP](#) [UK Independence Party] is related to this, which got, I think, about 14—I can't remember the exact percent of the vote.

Cameron came in with a promise to reduce net immigration, which is a crazy promise to make, since there are no levers to control net immigration since it depends on how many leave the country, from the neighborhood of 300,000 to below 100,000. He failed completely. That has been a big problem. It was a stupid promise, and he failed to deliver it. So net immigration continues to be very, very high in the UK. Last year it was a record.

The UK economy, interestingly, seems to be able to absorb this with stunning success. I have been truly astonished at how good we have been at generating jobs. I don't think we know why, but it's good to be puzzled by something that is working rather than something that isn't. So it has not been an economic problem. But it creates big pressures socially. Above all, since we don't have a housing market that works, it creates big, big problems in the housing market. Of course, it enormously increases the spending we have to do on education. It puts lots of pressures on social infrastructure, particularly in London. People feel this.

The reaction to this on the Conservative side, and to some degree even on the Labour side, is that we've got to stop this. We can't do it within the European Union, because as long as we are in the European Union there is free movement of people. Schengen allows us to control our borders, but it doesn't allow us to stop members of the EU from moving.

On balance, I think the majority of the population accept that, but there are probably about a third of the electorate who will vote against the EU—maybe fewer, maybe a quarter—for that reason. It is the only way to get control of our borders.

Then comes along the migration crisis, the refugee crisis. Completely unexpected. Europe as a whole loses control over its borders, and hundreds and hundreds and hundreds of thousands of people arrive, many of them—not all, but clearly many of them—genuine refugees. What is happening, of course, is breaking the standard asylum rules, which are that you seek asylum in the first country you get to that is safe. To be fair, I don't think the Greeks and the Italians can cope with this, so I think that is perfectly reasonable. But it breaks the rules. And they, of course, all want to go to stable, rich Northern countries with lots of jobs. Germany is one highly favored country, but lots of them clearly would like to come to the UK, which has lots of jobs and is reasonably stable and rich.

The British are desperate to keep them out. This is absolutely clear. The way we can prevent them seeking asylum is to prevent them ever getting in. One of the advantages of being on an island is that it's relatively easy to do so—relatively easy; not perfectly easy, but relatively easy to do so.

The policy has been to say, "We are a fortress island. We will not allow any of these people in. You deal with them, because they got to you first. France, Germany, it's your problem." That has become politically unmanageable for them, and they have been forced to accept a certain number, which will create many big problems for him.

My vision of the future on this is, one, we will be forced to take more, which is right. I'm not complaining; I am perfectly happy with that. We won't take enormously much more, maybe 50,000, maybe 60,000. It is not going to be 200,000 or 300,000. That's just not going to happen. The government will fall over that, I have absolutely no doubt. Our determination to tighten up border controls will increase beyond what it already is, which is very, very substantial indeed. This is going to create a lot of friction.

But let me just say one final thing, which is the thing I have thought about most. This is a manageable crisis for Europe and for Britain, a secondary part of it, provided the Europeans find some way of regaining control over their borders. If they can't regain control over their borders, it is just not clear where it ends and what it does. But one possibility is that borders go up all across Europe. Countries—I think you have seen this with Denmark; you see it with Austria and Germany—will not

accept that their neighbors, because of the complete free movement, are able to make policy decisions on immigration which not only change the ethnic composition and religious composition of the country that makes the decision, but also of everybody else. In this situation, fundamental sovereignty considerations will, I believe, arise, and people will say, "We alone can decide who is going to be in our country. If you accept that millions and millions and millions of people, many of whom will move on, we're not going to accept that."

So I think it is potentially very, very threatening to the free-movement-of-people principle in the European Union. They have to regain control over their borders and then decide how many asylum seekers in aggregate they are going to take. I don't think the quota system, by the way, can be made to work ultimately, because you can put people wherever you want, but they can move. So the quota system, which is what [Juncker](#) is proposing, is sort of misleading. It's not the way this thing can work. It has to be done in aggregate in an agreed way. It is a very big problem politically for the whole of Europe. Britain is just a small part of that.

**QUESTION:** Anthony Faillace.

You quite rightfully pointed out that Europe is running now a huge external surplus of 3 percent of GDP and, more shockingly, that Germany has an 8 percentage point GDP surplus. You also said we lack policy tools. Well, there is one obvious policy tool, which is that a country that runs an 8 percentage point of GDP surplus could run more stimulative domestic policy. You are talking to everybody in your position. What on earth are the German policymakers thinking? How can they imagine that this is a sustainable equilibrium over any intermediate period of time? Who is advising Mrs. Merkel on the process of educating the German public that they can't continue to run this type of policy?

**MARTIN WOLF:** When I said they didn't have policy tools, I meant they don't have policy tools at the aggregate level. Fiscal policy is a national priority, unless you run excessive deficits, in which case the European Union will, at least in principle, come down on you like a ton of bricks. There is nothing in the structure that they have now to even advise in any serious way, let alone compel, any state to run larger deficits if it doesn't want to do so.

Interestingly, they have discussed a mechanism for dealing with current account balances. There is a mechanism for doing that. But again—and this is a problem we have known about at the global level since the [Bretton Woods](#) discussions, because [Keynes](#) was very concerned about this—there is no mechanism to force a country to reduce its surplus. There is just no mechanism, short of allowing other countries to impose some sort of tariff barriers against them, and, of course, that is completely inconsistent with the European Union. So Germany can run any fiscal policy it wants.

Then the question is, why doesn't Germany choose to run a different fiscal policy? The answer is, from the German point of view, "Why should we? We have full employment. We have a perfectly satisfactory inflation rate, below 2 percent, but not wildly below 2 percent. The economy in GDP-per-head terms, standard of living, has done really better than any other major developed country since the crisis. So we're fine. Everybody else is doing everything wrong. If you all become like us, it will be perfect."

Then my joke is, "And we'll be running a very, very large surplus with Mars." But that is not their problem.

They would also add, "The reason we've got this huge surplus is not because we are doing anything wrong, but because we produce wonderfully competitive products, which everybody else wants to buy"—by the way, which is, of course, true; that goes without saying, of course it's true—"and so basically everybody else in the world is wrong."



When these points are made to them—and I can assure you that every policymaker in the world has been making these points to them—they say, "You're wrong and we're right."

There is nothing to force them. Mr. [Schäuble](#) is the most influential person talking to Mrs. Merkel, and though she thinks he is a little bit extreme, that is what he is telling her. To a great extent, even the [SPD](#) [Social Democratic Party of Germany] thinks in similar ways. This is stability-oriented German culture to extremes. They would say, in addition, "We have an aging society, with large costs associated with that. Our public debt is not that low," which is true—it's not that high, about 60 percent of GDP—"and we need to get it down. That's the rub. We need to get it down. If that causes a few problems for others, well, they're just going to have to sort it out in some way."

Could anything change this within Germany? Well, importing about 10 million immigrants would help. That really would. They would have to spend a lot of money to house them and so forth. So I think, actually, the huge inflow of immigration could be a great help to Germany. They have to build schools and hospitals and so forth, infrastructure, houses. That might generate quite nice growth in demand. Remember, this is a country with a really rapidly aging demography. It's very bad, like Japan or Italy. It's really bad. So that would help.

Then the other thing I thought one could say to them—but I have failed on this completely, and everybody else is—"We understand you're neurotic about current spending, but what about some infrastructure spending?" It is getting a bit decrepit in Germany. This is amazing. They can borrow for 20 or 30 years on real interest rates which are somewhere in the neighborhood of -1.5 to -2. It really does show a serious lack of imagination if they can't find anybody in Germany who can invest productively something that at least earns a zero return. But they apparently believe they can't. But you have to persuade them of that.

I would still hope that a big infrastructure boom, possibly even a European-wide infrastructure boom, will be one way out of this. But at the moment, the lack of leverage on Germany is complete. Germany feels, perfectly understandably in many ways, that things are absolutely fine. Their economy is in great shape, and because of their prudence, their appropriate attitude to finance—I won't go further on that—they avoided the worst of the crisis, and it's everybody else's fault, and everybody should be like Germany, and there will be no problem.

By the way—this is the point perhaps you should leave with—they have willy-nilly, from the point of view of others, largely internalized this view in many other countries in Europe, which is why they are becoming more Germanic. They all run closer-to-balanced budget. They all have depressed private sectors, with finance highly constrained, not likely to change radically after these huge financial shocks, and they are all generating very significant or even quite large current account surpluses—not at 8 percent, but still very large. The Netherlands', I think, is even bigger.

The only country that really, really doesn't like this model at all, is really resistant to this model, is France, as we will see in the [coming elections](#). But the French now have essentially—no, that's not true. They were crucial in Greece. The reason Greece wasn't thrown out is because of [Hollande](#). The Germans wanted them out. I won't go into that in detail. Schäuble wanted them out. Hollande said, "That can't happen."

So France in key points does have still important influence. They don't want a complete break. But on economic policy regime and economic policy orthodoxy, the eurozone is a Germanic system now. It is very important to understand that. They won the intellectual war in the eurozone. It is their model, for better or worse. And they think the fact that the eurozone is now growing just a little bit and two or three years from now the economy will be back where it started, that is a tremendous success.

I think you have to recognize that there are different standards of success. When I say, "This isn't

success. It's a catastrophe," and they say, "We're building the basis for European prosperity for the next 200 years"—my response to that is you can't plan for 200 years.

Anyway, that's where we are.

**JOANNE MYERS:** Thank you so much for being with us.

### **Audio**

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### **Video Clips**

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