CENTRE FOR EUROPEAN REFORM

Conference report: The politics of slow growth in Europe

Ditchley Park, Oxfordshire
16-17 November 2018

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Executive summary

November's Ditchley Park conference brought together 50 leading economists to consider the politics of slow growth in Europe. While Europe's economy is finally recovering, the long-term outlook remains weak, due to low productivity growth. Changing demographics will place an increasing strain on public services and the welfare state. And the rising influence of populist parties may make pro-growth reforms harder.

Broadly, there were four questions the conference sought to answer about how Europe should deal with a slow growth environment.

The first question was: can governments raise the structural rate of growth in the European economy – and if so, how? The conference agreed that there had been a slow-down in the trend rate of growth since the 1970s, which the Great Recession had made worse. But economists still do not fully know why productivity has been so disappointing since 2008; there were as many explanations for weak productivity growth as there were solutions for it. In order to boost innovation and investment, participants suggested greater use of competition policy in markets with high levels of concentration, deepening the single market in services and capital markets, taxing more innovation-friendly equity on the same basis as debt, stronger labour rights, and more training and education to foster the adoption of new technologies. It may be that governments should throw the kitchen sink at the productivity problem, trying multiple reforms at once, and hope that some of them bear fruit.

Would workers take a larger share of the pie in the future? The conference tended towards pessimism. Some participants thought that the 'China shock', which had raised the global supply of labour and curbed workers' bargaining power in the West, might go into reverse as China was ageing rapidly. Sub-Saharan Africa, the potential 'new China', may not be able to integrate into the global economy without better governance. But there were other reasons to think that 'weak labour' would continue – trade union membership continued to fall across the developed world, in part because manufacturing's share of output was declining, and education expansion, an important driver of wage improvements since 1945, would be difficult to repeat. The conference's proposals included government intervention to strengthen labour's bargaining power, including higher minimum wages, higher investment in education and skills, and taxing wealth and inheritance more to raise funds for investment. Participants agreed that more redistribution would be hard to achieve politically in a slow-growth world.

How should macroeconomic policy respond to low growth? There was a fair degree of consensus that productivity growth and macroeconomic policy were linked. Unless policy-makers acted decisively to stabilise the economy, structural unemployment rose, reducing long-run productivity levels, and investment was deterred. Many participants argued that central banks should not 'normalise' monetary policy too early; and that European policy-makers needed to use fiscal policy to help the European Central Bank (ECB) revive the economy. Others went further, suggesting that Europe should try to run a 'high pressure' economy, with loose monetary and fiscal policy, in an attempt to raise growth. But many participants were sceptical that counter-cyclical fiscal co-ordination between member-states of the eurozone would be politically achievable. Some even questioned whether it was desirable in the context of Italy's debt burden and the risk that posed to the currency union as a whole.

Finally, how should moderate parties deal with zero-sum politics, with workers, retirees, rich and poor fighting to retain their share of national income? Many participants agreed that politicians had overlooked the risks facing people who were born or stuck in weaker regions. Some argued that finance ministries should put more weight on the political backlash in deindustrialising towns and cities than 'cost-benefit' analyses for supporting struggling regions (which usually found that subsidy was too costly). Most agreed that more redistribution would be difficult if growth continued to be very slow, because the strongest pressure to increase public spending would come from older people: health and pension spending was set to rise as Europe's baby boom generation entered old age. Social democrats were doing badly in Europe because they needed stronger tax receipts to fund their priorities. There were a few radical proposals from conference participants: one suggested that governments borrow on a large scale and use the money to buy equities, with profits distributed to citizens. Others proposed a commitment to universal tertiary education. But the conference was divided on whether moderates needed to be conservative, holding the line against populist damage, or try to persuade the public of the merits of a more productive radicalism than was on offer from the populists. Yet participants agreed that some way had to be found to prioritise investment in the future and find a way to say no to the growing ranks of Europe's retirees.

Session 1: What happens to our politics if our economies do not grow?

The rise of populism may be part of a negative spiral of economic frustration leading to support for the political extremes, which leads in turn to policy that harms growth in the long run. Weak growth also makes it harder for moderate governments to tackle the sources of economic frustration, such as income inequality. How might slow growth change the political economy of Europe? Is there a way to prevent our politics from becoming nastier? Do moderate parties need more radical economic policies? And how do we tackle the distributional conflict between young and old?

The first panellist noted that the politics of growth was broken. From 1980 to 2014, the pre-tax real income of the bottom 50 per cent of the US population had grown by just 1 per cent, while the top 10 per cent had seen growth of 120 per cent and the incomes of the top 1 per cent had tripled. There was a perception that growth was divisive, with larger cities doing better than the rest of the country as in France, and environmentally damaging. In Italy, there had not been any growth per capita for 20 years. And there were further challenges ahead. Aging populations meant that the ratio of retirees to workers was going to increase – which implied higher taxes for workers or lower incomes for pensioners. If governments were serious about tackling climate change, there needed to be carbon taxes. While globalisation had increased average incomes by lowering the price of consumer goods, this would not continue and may even be reversed as traditionally low-wage countries like China developed. The panellist argued that European countries should try to revive or reinvent the political growth consensus, through more pre- and redistribution and more emphasis on the impact of growth on the environment. The idea that slower growth was the solution to the climate question was nonsense but nevertheless widespread.

The second panellist said that populism today was different from the 1970s – it was now a reaction against unprotected globalisation and technological progress, and was characterised by opposition to immigration and fiscal austerity, and a belief that the euro was not worth improving. Policy-makers had focused too much on monetary policy since the crisis, and not enough on fiscal policy, he said, noting that the ECB was the only central bank in the G10 that had not changed its policy framework since 2007. European welfare systems were also increasingly outdated in today's services-based world: globalisation, technology, and off-shoring had led to 'winner takes most' markets, and risk had been transferred from companies and governments to workers. This job insecurity had fuelled protest votes. Europe should follow Japan's example, he said. Reforms should aim to boost demand rather than cut costs. If a job were no longer a guarantee of a middle-class life, there would have to be more 'pre-distribution'. This could mean increasing the minimum wage, establishing a universal basic income system, and boosting investment in failing regions. He predicted that, in the US, the discussion would shift to how to implement such remedies by the 2020 elections.

The third panellist noted that advanced economies had lost half a point of annual growth since the crisis – slightly less in the US and slightly more in Europe – and the outlook for potential growth in the next few years was uncertain. The picture looked less bad after taking into account demographic changes, and recent data was slightly better. Nevertheless, smaller increases in purchasing power meant we were in an era of diminished expectations. At the same time, the remaining fiscal capacity of states was slim. Debt-to-GDP ratios had increased and low growth made existing debt levels less sustainable. Pro-growth policies that increase deficits, such as tax cuts or higher investment, had to be balanced against the need for redistribution, which made for tricky political choices. The first priority should be policies that did not involve spending, such as increasing competition and incentives to increase labour force participation. Investment in education was costly but increased political cohesion. Reducing taxation had to be shown to be effective before being chosen. There was also a need to renew international co-operation.

The fourth panellist looked at the question from a German perspective, arguing that political problems today were not caused by the pace of economic expansion. The real problem was economic insecurity. Europe needed a strategy to enhance social cohesion and reduce support for populists, even in an environment of slow growth. The main pillar of such a strategy should be reducing the insecurity of low and medium-income earners. In Germany's case that would involve a substantially higher minimum wage. Unemployment benefits also needed to be reformed, with lower social security taxes for low earners to encourage full-time work. Pensions needed not a time-limited but an indefinite floor below which they could not fall. He estimated that such a floor would cost 3 per cent of GDP per year, which could be financed by taxes on capital and land, a reform of inheritance tax, additional financial sector taxes and some form of mild indexation of the retirement age to life expectancy. He also advocated a re-think of subsidies for private sector pension schemes, noting that the returns on these were very low. Germany also had a huge equality of opportunity problem which required more investment in areas like childhood education and after-school programmes. But that approach would not be possible with Germany's current 'debt brake', which needed to be reformed. He suggested changing the rule to exclude certain key investment from the calculation of the deficit.

In **the discussion**, the participants first explored the link between weak growth and the legacy of the economic crisis on the one hand, and the rise in populism in Europe on the other. But they also noted there were several other long-term factors shaping Europe's politics, from globalisation to technological progress. Several participants said pessimism about the future was a major reason for the rise of populism. One said this was not only a legacy of the financial crisis, but also the result of other factors such as the increasing use of robots and artificial intelligence, and a sense of powerlessness and that decline is pre-ordained. Another argued that there may not even be an economics-related dimension to the question – expanded media choice and cultural identity were much more important. One participant said low growth encouraged politicians to blame scapegoats, such as immigrants, and noted a general deterioration in debate and a detachment between evidence and prescriptions.

Others argued that growing inequalities within countries, of income, wealth and opportunity, were behind poisonous politics rather than a general malaise in the wake of the crisis. One participant noted this did not necessarily mean the solutions were exclusively national. It was worth thinking about some European or even global initiatives that might help, such as co-ordinating international taxation. Another added that there was a danger that focusing on within-country inequalities missed bigger shifts, such as growing protectionism and trade frictions between US and China. European governments needed better co-ordination at a eurozone or EU-level, another discussant added, to avoid beggar-thy-neighbour domestic policies. But one participant argued that it was hard to see a correlation between countries facing a surge in populism and rising levels of income inequality. The key reasons were inequality of opportunity, fear of status and frustration at stagnating incomes. The amount of tax governments raised seemed to be a social and political choice rather than an economic one. Another speaker said politicians in the developed world over the last 20 years had made platitudinous speeches about the importance of social mobility, but they would find that harder to improve in a world of slow growth.

Several participants discussed the macroeconomic policies needed to spur growth and fight populism. Some advocated a stronger fiscal stimulus, with one suggesting a multi-year public investment programme for the eurozone, financed by euro bonds. Such a move would stimulate activity and raise interest rates, which in turn would help monetary authorities meet their inflation target. Europe was too obsessed with debt ratios and needed to lose its fear of using fiscal policy as a cyclical stabilisation tool. Several participants said there should be greater political effort to rethink safety nets. European governments generally did a good job covering citizens' health risks, but did less well on old age and unemployment; and were terrible at helping those who were born in the poorer regions.

The discussion ended with thoughts on the role of the state. One participant argued the corporate world could do more to reduce its surplus and increase spending, and if they did not, taxation would be necessary. Another argued that populism was a revenge of people in places that had done well from rises in asset prices, who were now biting the hand that fed them, and pointed to the Brexit vote as an example. Making the state bigger would not necessarily help, he said. One speaker noted that while economic insecurity had been increasing, centre-left parties had bought into a consensus that raised risks for workers and had therefore lost the trust of their voters. Some participants said social-democratic parties were doing badly because they were responsible for painful policies during the crisis or had worked with parties to their right. But one speaker noted that the rise in nationalism had also been accompanied by increased support for green parties.

Session 2: What explains the productivity slowdown?

There are several potential reasons for the slow growth in productivity across the advanced economies since the mid-2000s, and in order to tackle the slowdown, we need to know why it is happening. The financial crisis could be the main cause, but with strained balance sheets, weak demand and uncertainty reinforcing each other to create low investment and productivity growth; in this view, the recovery might herald higher productivity growth in future. But the rate of innovation or the speed with which technology is adopted may be slowing, limiting potential growth. Another example could be the rise of highly productive superstar firms and an army of laggards which fails to catch up, in part because competition is weak. Or is it best explained as a statistical artefact because we cannot measure productivity properly?

The first panellist noted that productivity growth in the US and Europe had averaged around 2 per cent per annum over the last century, but there had been spikes - in the US in the 1930s and 40s, of the order of 5-6 per cent, and in Europe from the mid-40s to the mid-70s above 4 per cent. But from the 1970s onwards productivity growth had been on a declining trend, albeit with Europe mostly beating the US until the 1990s, when the US had a 10-year peak fuelled by the information and communications technology revolution. When looking at Europe, it made sense to split the region between the rich core, lower-income Southern Europe, and even lower-income Central and Eastern Europe. The last of these groups was converging with higher-up groups. The southern countries that were hit badly by the downturn, Spain and Italy for example, had low productivity growth even before the crisis. This was in part because during the upswing funds went towards construction sectors, which had low productivity, but also their financial sectors did not finance good projects.

The second panellist said there were a number of reasons why our ability to measure productivity may have worsened, including the increasing importance of 'intangible' assets, such as branding and proprietary data, and difficulty in measuring prices in digital-intensive sectors. However, most research suggested this was a small factor and the slowdown in productivity was real and not a product of mismeasurement. There were several reasons to believe the financial crisis had a role in the productivity slowdown, even if it was not the main factor. Firms had fewer funds to invest and finance innovation, as did governments. The crisis weighed on trade, slowed innovation, led to resources being misallocated by finance, and people taking jobs that they were over-qualified for. It had also weakened financial institutions, which in turn led to the survival of unproductive in 'zombie' firms, which would fold in a normal competitive environment. However, the panellist also noted that the slowdown in productivity started before the crisis. Firms that used digital technology more effectively were more productive, and these were concentrated in manufacturing and other sectors which involved routine tasks. The labour share of income in these firms tended to decline. And laggard firms had fallen further behind those at the frontier since the slowdown in productivity growth had started.

The third panellist said he did not know what explained the productivity slowdown, and suspected nobody else did either. The Paul Krugman line, "Productivity isn't everything, but in the long-run it is almost everything," needed the additional clause: "and if we're honest we don't really understand what drives it". There were dozens of possible answers to what drives productivity, including the rule of law, institutions, property rights, product market and labour market regulations, management techniques, labour relations, and technology. He also acknowledged the problems in measuring productivity due to rapidly changing digital technology, statisticians overestimating inflation, or a large consumer surplus. However, these did not explain the slowdown. If real growth had been stronger than measurements suggested, then why were so many people miserable? Changes to labour markets might provide some answers: productivity must grow to allow wage increases, and it might be possible that weak pay growth could lead to weak productivity growth. The argument that robots were stealing jobs was a red herring given the low productivity growth and high employment rates in the US and UK. Humans might be stealing robots' jobs, and lowering productivity: human car washers had taken the place of roller car wash machines in UK over the last two decades, for example. Since pay growth had been so weak, it was cheaper to hire humans than buy a car washing machine. Perhaps labour bargaining power was structurally lower. This might have been holding back investment and could be part of the answer to the productivity puzzle.

The fourth panellist said Germany's low productivity growth was a big concern because of its ageing population. He noted there had been a drop in productivity growth from 2 per cent in the 1990s to around 1 per cent since 2005. Germany had created 3.5 million jobs in the last 10 years – most of them in the services sector. This shift away from manufacturing to services had had an impact on productivity as services sectors were less productive, but there were other factors at work. Productivity had increased in IT, communications and real estate sectors over the last 10 years, but many new jobs had been created in the public sector, like in health, education and transport. It was difficult to measure the productivity of, say, teachers. The German corporate sector had a financing position that had shifted from a deficit of 5 per cent of GDP 10 years ago to a surplus of 5 per cent in 2018. Companies were holding on to cash, rather than converting it into capital stock. There were few zombie firms in Germany, so that could not explain the puzzle, but the diffusion of innovations across the German economy was slowing drastically.

The discussion focused on the impact of Europe's recent economic crisis. One participant suspected the economic slump had led to a reduction in spending on human capital and research and development, which compounded a misallocation of capital in the run-up to the crisis. He suspected the crisis had increased the number of oligopolies and reduced diffusion of innovation. There were some different views on where Europe was on the innovation scale. One participant said productivity trends over the last century were related to what British-Venezuelan scholar Carlota Perez called waves of innovation. He suggested we may need to wait for the next big thing to know the extent to which long term productivity trends were tied to technological cycles. But another participant said we were at the beginning of the process of innovation, although it may take some time to organise competition.

Several participants thought that demographics might weigh on investment, innovation and productivity. Ageing populations reliant on pensions had prompted increased pressure to turn equities into something like bonds, with more dividend payments and share buy-backs, which in turn discouraged companies from taking risks. But one participant disagreed, pointing out that in Germany there were different corporate structures and governance but similar productivity problems. That rather undermined the notion that Anglo-American shareholder models weighed on productivity growth. One participant noted that older entrepreneurs in Germany were less likely to take risks, unless the entrepreneur had a family member or protégée who would take over the business. Another said that the rate of start-ups in Europe was weak compared to the US, a point that others echoed. And another argued that the slowdown in productivity was related to the shift in the economy from value creation to value extraction epitomised by the explosive growth of the financial sector. This had drawn resources and talent away from more productive areas of the economy.

The impact on productivity from technology and innovation and corporate competition was a key focus. One participant noted how more productive firms were better at adopting new technology and benefiting from it, thereby exacerbating the gap between the leaders and the laggards. She wondered if government should have a role in helping with technology planning. Some participants said the weakness of the banking sector in the wake of the crisis may have led to companies being kept in business that would have folded in more normal economic circumstances, so-called zombie firms, who were kept alive because banks did not want to write down non-performing loans. There was some discussion about whether the latest wave of technological progress may be leading to weaker productivity growth, not stronger. New internet companies might be productive in their early phases as they brought new technology to the market and gobbled up competitors, but they became less productive once they controlled the market. Big technology firms had become so good at buying competitors and data that they had become monopolies and had created big barriers to new entrants.

There was broad agreement that productivity was hard to gauge. But while most concurred that the measurement problem could not explain the slowdown, one participant argued that it was potentially huge and therefore could have big policy implications. Another participant said the mystery about how to fuel productivity suggested policy-makers should perhaps throw everything at the problem, and listed a range of possible policies including more funding for training, universal tertiary education, higher minimum wages, more counter-cyclical fiscal policy, and taxing corporate savings. A panellist concluded that we either accepted we were stuck in a low growth cycle or policy-makers should keep experimenting and trying these new things, most of which were unlikely to have much downside.

Session 3: Will the median worker do better or worse in the future?

Labour's share of income has been in decline in many parts of the world since 1980, and income inequality has risen. The primary drivers of these developments have been skill-biased technological change; globalisation – especially the establishment of cross-border value chains – and the entrance of more than a billion low-skilled workers into the world economy, notably from China; and government policy, as shown by different outcomes for labour in different countries. Will the future combination of technology, globalisation and demographic change be different? Will the future proceeds of higher productivity resulting from automation be shared more widely? Will global demographic change increase European workers' bargaining power? And will technological advances lead to a shortening of global value chains, or will they lead to a new phase of globalisation in services?

For **the first panellist**, demographics was the biggest reason for slow or stagnant real wage growth and the rise in income inequality within countries. The entry of China and other emerging economies into world markets – alongside the demographic bulge of the baby boom generation in the developed world – had doubled the size of the global labour force. As a result, labour in the developed world had had less bargaining power. Trade union membership shrunk as fewer people were employed in union strongholds such as manufacturing and heavy industry. But there were signs that this demographic trend was going into reverse. The baby boom generation was entering retirement, and fewer adults were entering the workforce. China's population was aging, too. This meant that labour's bargaining power would grow, and real wages would increase. Investment would also have to rise, in order to make use of labour-saving technologies. As a result, productivity would grow. Far from being something to fear, artificial intelligence and robotics would be needed to cover for scarcer labour. Rising rates of dementia would be a particular problem, since people suffering from it would need a lot of care.

The **second panellist** pointed out that the 'essay question' for the panel was ambiguous. The median worker would do better in the future in the sense that real pay would grow. But he cautioned that growth would be slower than in the past. Since the financial crisis, the UK had experienced a pay catastrophe. There had been two major falls in the pound in the previous decade – in 2008-9 and in 2016 – which had raised inflation, eroding consumers' buying power. And while real pay losses had been widely shared by the British population, with even the top 10 per cent of earners taking a hit, the young and men had seen the biggest falls in real wages. There were three big challenges to living standards in Britain. First, would the workforce become more highly educated and skilled? Rising educational attainment had led to real wage increases in the past, but Britain's education spending had been flat as a proportion of government spending since the 1960s, while three times more of the budget had been swallowed up by health since then. It was difficult to see how more people would go to university, after the big expansion from the 1980s. Meanwhile, training funded by the private sector was falling, and there had been a 45 per cent cut in adult skills funding since the UK started its austerity programme. The second challenge to living standards was declining labour power. Trade union membership was in secular decline, because millenials signed up to unions in smaller numbers than retiring baby boomers. That meant that unions' pay bargains would have ever weaker effects on the non-unionised sector. The third challenge was that the government would have to raise more tax revenue, curbing household consumption. Marginal tax rates were already high, thanks to fast tapers for tax credits and higher university tuition fee repayments. The government would struggle to raise marginal rates higher – it would need clever new ways to raise tax.

Economists made two big forecasting errors in 2007, said **the third panellist**. They predicted GDP in a decade's time would have been much higher than its actual level in 2017.

And those that predicted the crash assumed a much bigger jump in unemployment than we experienced. The reason behind these wrong predictions? Weak productivity growth. The neoclassical view was that reducing wages would raise employment, while Keynesians believed that wage cuts would lower domestic demand and reduce employment. The neoclassical view had been proven right thanks to flexible labour markets, with flexible hours, more outsourcing, greater use of technology to cut costs, and the use of 'gig economy' apps to create competition for routine tasks. Demographic changes meant that pay growth for median workers would be weak in the future: companies were paying dividends instead of investing, because equity-owning baby boomers were no longer content with capital growth. They wanted cash out of their retirement funds. And Africa's share of the global population was set to rise to 45 per cent by 2100. If those workers were not integrated into global supply chains, as had happened in China, they would migrate to richer regions. Either way, they would expand the global labour force.

The fourth panellist pointed out that workers' pay had not grown in line with productivity growth, leading to a decline in the labour share of income and increasing inequality in many European countries. Technological change, which had curbed pay at the bottom end of the skills spectrum, was important; but policy choices were also a big factor. Higher wages would reduce social unrest and calls for protectionism, raise demand, and increase productivity because more pay would elicit more effort from workers. Since downward pressures on pay would not recede, however, governments needed to use 'pre-distribution' policies more than ever. These included supporting trade union membership and taking other measures to strengthen the bargaining power of labour; and more investment in education and skills. Public subsidies for education and training were important to encourage individuals to invest in their own human capital, because of the opportunity cost of foregone earnings. Finally, she argued that there may be a trade-off between growth and fairness, and that slower, more broad-based growth would be better than faster, more unequal growth.

The argument that the demographic headwind against pay growth would reverse proved controversial **among the audience**. One conference participant pointed out that Japan's aging population had not led to faster real wage growth, despite a fall in labour supply. Another agreed with the third panellist that African population growth might lead to a positive labour supply shock through migration. Two people argued that there would be pressure to include older workers in labour markets: according to projections, half of children born in 2007 would live to 100, said one. Another argued that semi-retirements would be sensible, because young and old workers could complement each other. The first panellist responded by saying that Japan had achieved 2 per cent growth per worker annually as the size of the workforce fell, and other advanced economies would be pleased if they managed productivity growth of that magnitude. And for Africa to join in global supply chains, it would need good government, capable of providing better infrastructure and better education – and the jury was out on whether that would happen.

The conference was broadly pessimistic that governments would be able to raise taxes to fund greater redistribution. One participant pointed out that many tax systems were 'flat': after taking all taxes and social contributions into account, the tax take from different parts of the income distribution in many countries was largely in proportion to their share of national income. To the idea that governments should do more to tax wealth, another member of the conference said that parliaments were over-represented in people who owned immobile factors like land and housing. While the Organisation of Economic Co-operation and Development (OECD) was doing good work on co-ordinating the taxation of more mobile capital, he argued, it was difficult in a world without capital controls. The second panellist said that some governments had made things worse: the UK had cut income and corporate taxes while cutting expenditure during its austerity programme. He added that taxing the revenue from rising asset prices was politically difficult but crucial to fund redistribution. But he accepted that raising VAT and direct taxes were also needed to cover long-term pressures, especially the elderly's use of healthcare. There would be a lot of resistance from taxpayers and right-wing politicians, however. Increasing minimum wages more rapidly was an option, since their impact on unemployment had so far been shown to be limited.

If direct redistribution were difficult, others suggested that governments could try to intervene more directly in wage setting and labour bargaining. Higher minimum wages and trade union membership would result in higher median wages. Training and education were more likely to be effective than using employment protection legislation, according to the fourth panellist, and trade unions could co-ordinate with employers to make sure wage and price developments benefited workers.

One participant called upon the conference to consider the link between labour markets and populism. What was the true source of discontent? Was it wages? Anxiety about unemployment? Or was it about the quality of work? The second panellist concluded that more volatile incomes and downward earning mobility – which were a big problem in the middle of the income distribution – must explain part of the discontent. And men were now being subjected to labour market problems that women had long faced – volatile earnings, insecure hours, and overall, a reduction in hours worked.

Session 4: The macroeconomic implications of low productivity growth

Macroeconomic and financial policies can play a role in raising productivity growth, by channelling savings into productive investment more or less effectively. But how do we encourage more productive risk-taking? Do we need to boost equity financing instead of subsidising debt finance? And how do we ensure that surplus savings are invested productively across borders? Is it possible to maintain a sufficient level of demand and investment over the entire cycle, to avoid a vicious circle of low productivity, stagnant incomes, and weak incentives to invest? Low productivity growth also leads to lower interest rates, which has implications for monetary and fiscal policies. If we are more likely to hit the zero lower bound as a result of low productivity growth, do we need a broader re-think of monetary and fiscal policy?

The first panellist argued that macroeconomic policy and productivity were connected. If productivity rose, for example, then equilibrium interest rates would rise too, making life easier for monetary policy-makers coping with a low-inflation environment. It was also easier to make productivity-enhancing reforms when the economy was growing faster. And economic growth and productivity growth tended to happen at the same time: productivity catch-up occurred in periods of high growth. Thus good macroeconomic policy could help increase productivity. Fiscal and monetary policy had been tightened too quickly after the crisis, he argued, and there had been too much reliance on 'automatic stabilisers' (higher expenditure, such as more unemployment insurance pay-outs, alongside lower tax revenues in a downturn). These had not been counter-cyclical enough: there should have been more discretionary fiscal stimulus. Fiscal policy reforms were needed to improve automatic stabilisation, perhaps by making tax revenues from labour more cyclical. And health expenditure needed to be constrained in order to allow more space in the budget for education and other pro-productivity priorities. As for monetary policy, the key reform was to prevent early withdrawal of monetary stimulus. Quantitative easing had been introduced too late in the eurozone, and may stop too early. It would be hard to raise the inflation target, but policy-makers could use forward guidance to commit to higher inflation in the future to make up for undershooting the target since the crisis. And the next crisis might require helicopter money – direct payments of newly created cash to individuals – in order to make monetary policy effective.

For **the second panellist**, macroeconomic policy mistakes could damage productivity. Greater economic instability was not good for the reallocation of resources away from unproductive companies; and recessions caused scars ('hysteresis'), in the form of long-term unemployment or people leaving the labour market, among other things, harming productivity growth. The recent 'seven plus seven' report by German and French economists proposed eurozone policies to reduce and spread risk, which would help to prevent these scarring effects. The EU's macroeconomic imbalances procedure could be linked to macroprudential policy, so that the surplus of savings flowing out of Germany and the Netherlands did not lead to asset price bubbles elsewhere; banks' balance sheets could be made more counter-cyclical. And if this macroeconomic strategy were combined with policies to extend the single market, the EU would be able to raise productivity. A more integrated single market in services would raise GDP per capita by around 10 per cent, according to estimates. Barriers in capital markets were high, especially thanks to distorting tax breaks, such as those for reinvested earnings. Reducing these barriers would help the reallocation of capital to higher performing companies, especially those which use digital technology effectively, and promote consolidation of companies across borders.

The third panellist said that if we were in a world of zero productivity growth, monetary policy would be seriously impaired, and fiscal policy – especially automatic stabilisers – would become much more important tools for stabilising the economy. That would be very difficult to achieve in the US and the eurozone for political reasons. As a result, there was massive uncertainty about the path of future macroeconomic policy given the underlying uncertainty about productivity growth. In a low-growth world, forward guidance – perhaps price-level targeting, where the central bank made up for undershooting its inflation target in the past by overshooting in the future – was very difficult. That was because the real equilibrium interest rate was uncertain, as was the rate of unemployment consistent with the inflation target. Monetary policy in the next few years would be probing, testing out tightening to see how it affected activity, which was not a disaster, because central bankers' mistakes could be reversed. But financial markets had largely priced in a return to the 'old normal' of productivity growth, and if that failed to materialise, there would be a sizeable asset price correction. As for the question about macroeconomic policy's ability to raise productivity, he was sceptical. The proposal by the UK Labour party that central bankers should consider productivity was wide of the mark. He agreed with the second panellist that monetary policy could mitigate the costs of scarring. Fiscal union in the eurozone would help to raise productivity by reducing borrowing costs in the periphery. But politicians, not central bankers, should make decisions about distribution. Macroprudential policy, for example, could be used to steer investment towards regions, sectors or firms, by changing the cost of risk-taking by financial institutions. The state could shift capital from laggard firms to those at the productivity frontier. But that was up to politicians to decide, not central bankers.

The fourth panellist argued that looser fiscal policy in the eurozone would raise short-term and long-term growth.

The eurozone's fiscal space had not been seriously eroded over the last 10 years. Cumulative fiscal deficits since the crisis amounted to 25-30 per cent of GDP in the eurozone, and 70 per cent of GDP in the US. But the increase in the US debt ratio was somewhat smaller than that of the eurozone, because GDP had grown faster in the US. Over the next decade, the eurozone would run cumulative fiscal deficits of around 5-10 per cent of GDP, while those in the US would be 50 per cent of GDP or larger. One could argue that the US was being excessive in its attempts to run a high-pressure economy, but one could also argue that the eurozone was being deficient in its unwillingness to experiment. The eurozone had by far the tightest fiscal stance of any of the major advanced economies. A looser fiscal policy would be a good supply-side policy too by avoiding hysteresis, and the gains would be more certain than supply-side reforms. A wide range of labour market policies around the developed world had not made much difference to productivity in different countries. Taxing borrowing on the same basis as equity, rather than more lightly, made sense, but many big corporates were borrowing to purchase buy-backs of shares rather than investing, so it would be unlikely to make much difference. More aggressive macroeconomic policy would be more effective. Monetary policy had become looser in the eurozone, but needed help from fiscal policy to meet the inflation target. This meant that the eurozone's 60 per cent debt ratio target should go, and institutions were needed to ensure that the aggregate fiscal stance of the member-states was counter-cyclical.

Conference participants disagreed on the extent to which a high-pressure economy would lead to productivity gains. Since we did not know when inflation would bite, governments and central banks could go too far, according to one. Since the structural deficit was impossible to observe – and estimates were always best guesses – it made sense for the eurozone to allow higher deficits in exchange for reforms that would raise growth potential. Another pointed out that a high pressure economy had been tried in the US in the mid-2000s and that did not turn out well. Hong Kong, China, Singapore, Canada, France, Switzerland and Australia had seen very steep rises in private sector debt since the crisis, but there had been no evidence of any productivity improvement, and the risk was that it was storing up financial instability in the future. Come the next downturn, these countries, which had acted as consumers of last resort, may be unable to do much more, and the eurozone would be forced to move into current account deficit.

One think-tanker argued that the fourth panellist was wrong to suggest that the US was trying high-pressure economics – it was essentially an accident, thanks to Trump's corporate tax cut. And the eurozone could not do the same: US exorbitant privilege (its ability to borrow cheaply thanks to the dollar's predominance internationally) allowed it to take these risks. The eurozone was not one country, and it needed rules to prevent risks taken in one country from causing problems in others. It was justifiably conservative about inflation. Without a push towards fiscal federalism, which many participants from eurozone countries thought unlikely, this participant thought there should be a eurozone safe asset to make life easier for the ECB, and a 60-80 per cent debt ratio range for those countries willing to engage in meaningful structural reform. There was a fair degree of pessimism about fiscal co-ordination between eurozone member-states in order to maintain aggregate demand. One participant noted that we were going backwards, with fiscal expansion in Italy and a neutral stance in Germany. Another wondered if only geopolitical pressure would work: US protectionism might lead to more expansive macroeconomic policies in Germany, which would lead to higher purchases of US exports in Europe.

However, the fourth panellist retorted that real interest rates were lower in Japan and the eurozone than in the US, while Germany was reducing the supply of safe assets by cutting its debt ratio, and leaving riskier bonds on the table. The eurozone could have increased interest rates and inflation if member-states had borrowed more. The second panellist agreed, arguing that German current account surpluses were down to very high corporate saving, and the government could consume those surpluses by taxing companies more. Another participant said that the eurozone needed fiscal capacity centrally, preferably with automatic higher spending in downturns. And a participant argued that one reason why some countries grew faster than others was because they had recessions less often and their GDP contracted less far in recessions, suggesting that closing output gaps quickly was important to long-run growth.

There was more consensus over monetary policy. Many participants were in favour of price-level targeting, or tempted by it, as a means of preventing inflation expectations from drifting downwards and to help central banks get interest rates off the lower bound. Come the next recession, said one, more quantitative easing might even be counter-productive, because financial institutions would have fewer safe assets available for collateral as central banks swallowed them up. For another, price-level targeting would be a way for the ECB to signal that it would not tighten if inflation rose above target. That would help to keep growth going as long as possible, helping in turn to prevent an even greater political backlash than we were already experiencing. Another observed that the ECB mandate was asymmetric, with a target for inflation 'close to but lower than 2 per cent', which meant it had a tightening bias. He advised against calling policies to raise inflation when at the lower bound 'unconventional', as such a term showed that the ECB did not want to deploy these policies. The third panellist sounded a note of caution. It would be hard for central banks to convince financial markets that they could hit, say, a four per cent inflation rate – price-level targeting was not an easy win.

Session 5: Should governments be more interventionist?

The role of government in fostering economic growth and sharing its proceeds is increasingly contested. What were the successes of the set of policies loosely described as 'neo-liberalism' – deregulation, openness to international trade and finance, higher rates of international migration, privatisation, tax and spending cuts? What were its failures? Should governments do more to invest in ideas and technologies of the future? Should they take an equity stake in those ideas? Should industrial policy limit itself to regional development – transport, skills, housing and public services – or should governments try to shrink failed economic areas and move people to more productive regions? And how should governments deal with winner-takes-all technology markets – should they cut giants down to size, or tax them more? Can competition and intellectual property policy reforms play a bigger role in ensuring that the spoils of technology are spread more widely?

The first panellist argued there were three pressures for a larger role for the state. The first was the demand for more public spending, especially on healthcare, thanks to ageing societies, medical progress and citizens' insatiable demand to live longer. The second was the need to protect citizens from risks, such as the "risk of place" – the fact that people born in one place would have fewer opportunities than people born in another. That could be addressed by investment in transport and housing. The "risk of not being born rich" could be countered by investment in schooling but also through taxing wealth and inheritance. The "risks of the labour market" required the state to protect workers from sudden losses of incomes. And people could not individually bear the "risk of living too long", and the state was the default insurer. Third, many citizens wanted to 'take back control', perhaps by nationalising companies, controlling the provision of credit, or, in a milder form, using competition policy to curb the power of tech giants. The main constraint on a larger role for the state was raising the necessary funds. Taxation was hard, not least because globalisation had eroded tax bases. After World War II, governments had coped with the demand for more healthcare by cutting military spending, but that could not be repeated. And if macroeconomic stabilisation through fiscal policy would be more important in the future, there was a real challenge to distinguish between cyclical and structural increases in spending.

The second panellist pointed to the many battles won by those supporting economic openness and 'neo-liberalism'. But the successes of neo-liberalism stood in stark contrast to the magnitude of the current discontent. The costs of neo-liberal policies were often concentrated on particular regions, economic sectors or firms, and those affected pushed for either state intervention or compensation. But one of neo-liberalism's problems was the concentration of economic power: the top 1 per cent companies were increasing their share of exports, for example. The same was true for income and social mobility. In Greece those born into the top 20 per cent had a 75 per cent chance of staying there, whereas the bottom 20 per cent had only a 5 per cent chance of moving into the top 20 per cent. Education was a key policy to change this dynamic, but it had to be an education policy that prepared students for the labour market, which in some countries required a complete overhaul of the system. She also suggested that prior to the financial crisis, the increase in housing wealth had compensated the middle class for the increasing gap between middle and top incomes. But that mechanism was no longer working in some countries: the assets of the top 10 per cent, particularly equities, had done much better than real estate.

The third panellist argued that the UK had had many successes with policies that people consider to be 'neo-liberal'. EU integration and greater openness to trade had raised national income. Migration had had generally positive effects and the privatisation of some public companies, such as airlines or oil companies, had been successful. Even on the more controversial issues of financial regulation and the labour market, the flexibility of reforms meant better access to credit and higher female labour force participation, which were positives. Critics, she argued, did not want to roll back the clock to the 1970s. But there were legitimate grounds for criticism. The short-termism of companies and investors, which economists often failed to appreciate, was one example; another was the outsourcing or privatisation of some public services that were too complex and in which the private sector had little to no prior experience. On regional policy, she remained sceptical about whether the government could and should invest in specific regions. The state's role was mostly to provide the infrastructure, public services and the skills necessary for economic activity. Most importantly, the state should refrain from policies that discouraged economic activity, or discouraged people from moving to more prosperous regions of the country.

The fourth panellist pointed out that most economists agreed that markets were better at allocating resources than alternative forms of organisation, but that markets also failed in two important aspects. They took little account of the future, especially limited environmental resources; and they could not, on their own, achieve certain desirable social outcomes. He argued that there were four unsettled debates around state intervention in Europe: first, on how to distribute the gains of an economy in which winners took an increasing share; second, on how states could raise revenues from taxation when the EU had created the breeding ground for harmful tax competition; third, on how to regulate the economy – a state activity that did not strain fiscal resources

– where there was a superficial consensus, but no agreement on the details; and fourth, on how to improve European competition policy, and complement it with a European industrial policy. He added that macroprudential policy, which was a very important complement for a one-size-fits-none monetary policy in the eurozone, had not improved much in the ten years since the financial crisis.

The conference discussed whether fiscal resources were too strained to meaningfully increase the role of the state. One participant argued that health and pensions, and to some extent education spending, had become such a burden on the state that there was little room for spending on other areas such as public investment. Even tasks that were considered primary responsibilities of the state, such as defence and security (which were in fact true public goods, unlike pensions or healthcare) were being squeezed. He speculated that the only real solution, as indicated by tuition fees for university education in the UK, was a reduction in entitlements. Another discussant argued that increasing role of the state was the necessary result of the demographic change underway. He suggested that taxation of tech giants and their use of consumers' data would be one way to fund that state expansion. But that proved controversial. One panellist agreed that tech companies should be taxed differently if they tended to create monopolies. Another participant responded that there was nothing specific about tech companies. Instead we should fix the tax system for all corporates. One of the main failures of neo-liberalism, added another, was to allow cross-border tax arbitrage: most cross-border investment had a tax haven at one end of the transaction.

There was another missed opportunity, suggested another participant, namely the low interest rates which allowed governments to borrow to invest in equity. The profits made could be distributed to those without assets. Another added that, in the UK at least, the role of the state had to grow to remedy its own past failures to invest in public services.

But not everyone agreed that the state would expand: one channelled his "inner Hayek" and asked whether new technology could make previously publicly provided services private. One panellist agreed that such technological advances were indeed possible in healthcare, which could make the system more efficient. Others argued that there was a key separation between public financing and public provision of services, with one adding that the private provision of public services did not work well in some cases. One panellist responded that the role of the state was not so much the provision of public goods but rather the socialising of risks, and that function was very hard to replicate privately. Another participant agreed, saying that it was a major mistake of neo-liberalism to shift longevity risk onto individuals.

There was considerable controversy on whether social democratic parties, when in power in the 1990s and 2000s, had used the opportunity to increase redistribution or otherwise shape society in their preferred direction. One participant argued that the Clinton or Blair governments in the US and the UK, for example, had not – adding that conservative governments in both countries had overseen an increase in regulation in their time, contrary to their convictions. Two panellists disagreed strongly that Labour governments in the UK had not used the chance to redistribute. There had been big increases in pensions for the poor, and large increases in tax credits, in effect eliminating all of the upward pressure on income inequality at the time. But the fourth panellist said that it was true that the social democrats in Europe had bought in to the neo-liberal paradigm from the 1980s, and that in fact financial liberalisation had been aided by European socialists: it was not simply an American export. The second panellist agreed that there had been massive oversights, such as on corporate governance and the increase in the top 1 per cent of income, and on the importance of housing and place. Another discussant called for a healthy dose of economic populism to support a larger role for the state.

Many participants emphasised the key role of education in creating fairer and more inclusive societies. One argued that there was a shared view of the kind of society, subsumed in the German phrase 'social market economy'. Countries that put that view into practice best were Nordic, which he argued had not been taken up by social democrats elsewhere. Subsidising university degrees with a high pay premium, as one suggested, proved controversial. One participant argued that abolishing tuition fees, while popular, did not do much to improve education.

One participant asked the panel why they had been so conservative, painting the vision of an embattled state incapable of addressing the big challenges. In a way, he argued, the panel had argued for the centrist consensus. One panellist responded by saying that it was the consensus that had shifted towards a more active role for the state. Another apologised for having been so conservative, and added a more radical proposal: to give the state a much larger, entrepreneurial role in solving environmental issues.

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