Comments on Subacchi and Oxenford
Increasingly apart: The Euro area and the UK

Donald Kohn
Robert S Kerr Senior Fellow
Brookings
Overview

• Good paper: informative analysis of UK and EA growth since the GFC.

• Highlights relative greater flexibility of UK labor market as major reason for superior UK growth.

• Agree labor market flexibility critical
  – Even more for intra EA adjustment

Comments: 2 fns on UK; macro policy contributions to disparate outcomes
UK Footnotes

• Importance of product market flexibility.
  – UK has high product market flexibility and ease of firm entry and exit.

• Risks of consumption driven growth with C/A deficit.
  – See US 2004-07
  – High HH debt
    • Vulnerability to shocks and amplification
Macro policy differences UK-EA (1)

• Fiscal policy
  – UK responded more forcefully to recession
  – Both UK and EA tightened since 2009, but UK still has less restrictive policy than EA, cyclically adjusted
  – In EA constraints on fiscal policy in periphery not offset by expansion in countries with fiscal space.
Macro policy differences UK-EA (2)

- Monetary policy
  - UK rapid forceful response to recession
    - Rates, QE, FLS
  - EA slow, initial reversals
    - Now forceful: negative rates, asset purchases
    - But interest rate increases in 2008, 2011
    - 2 percent as ceiling, not goal; responses to headline
    - Critical importance of nominal growth for debt sustainability
Macro policy differences UK-EA (3)

• Macroprudential regulation—bank recapitalization
  – Both back debts and use government capital in crisis
  – Recovery held back in both by tight bank credit
  – UK recognized earlier recapitalization required for lending
    • Stress measure of adequacy
    • Faster phase in of B3
    • Tradeoffs: FPC mitigates risk of added restraint in short run
– EA handicapped by sovereign risk and national responsibility for banks
– Apparently reluctant to force private capital raises
– Impetus from banking union and asset quality review helped, but late
Summary

• Good paper: learned a lot about UK-EA
• Labor market flexibility is critical
• But so are differences in fiscal, monetary, and macroprudential policies
  – EA handicapped by cumbersome decision making and divided responsibilities growing out of currency area made up of sovereign states.
  • Some progress toward centralized decision making e.g. for banking supervision—but enough?