



Hochschule für Technik
und Wirtschaft Berlin

University of Applied Sciences

EMU reforms: Achievement and challenges

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Programme

1. Introduction
2. A look back: Causes for the euro-zone crisis
3. Pre-2017 reforms of the euro-area
4. Reform debates and progress since 2018
5. Conclusions

Introduction

- Hope 2017: Window of opportunity for reform in Germany and France
- A number of new reform proposals
- But: Delay because of delayed government formation
- Decisions at euro summit in December 2018
- In parallel: Growing conflict with Italian government

THE DIABOLIC SEVEN: CAUSES FOR THE EURO-ZONE CRISIS

The diabolic seven: Causes for the euro-zone crisis

1. Excessive deficits in some countries (Greece!)
2. Problems in the banking sector
3. Doom-loop between sovereigns and banks
4. Self-fulfilling market panics
5. Boom-Bust cycles in the periphery
6. Structural divergence of competitiveness
7. Loss of legitimacy because of dismal economic performance/feeling of political impotence

Crisis cause #1:

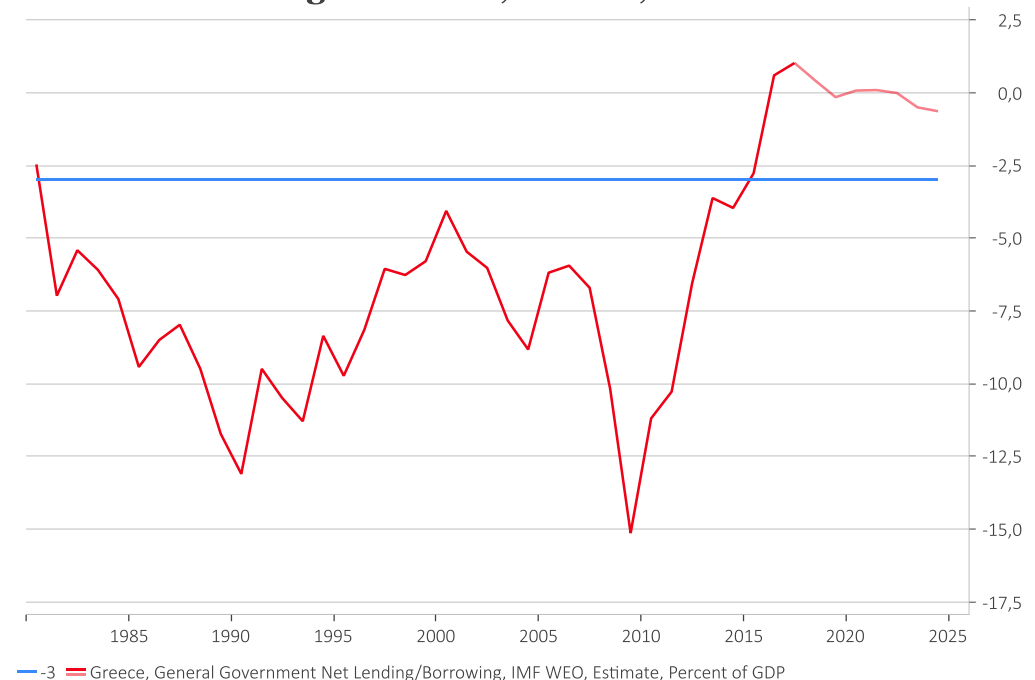
Excessive deficits in some countries

The crisis causes

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- In some countries (especially Greece) budget deficits were excessive

Government budget balance, Greece, % of GDP



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Crisis cause #2:

Problems in the banking sector

The crisis causes

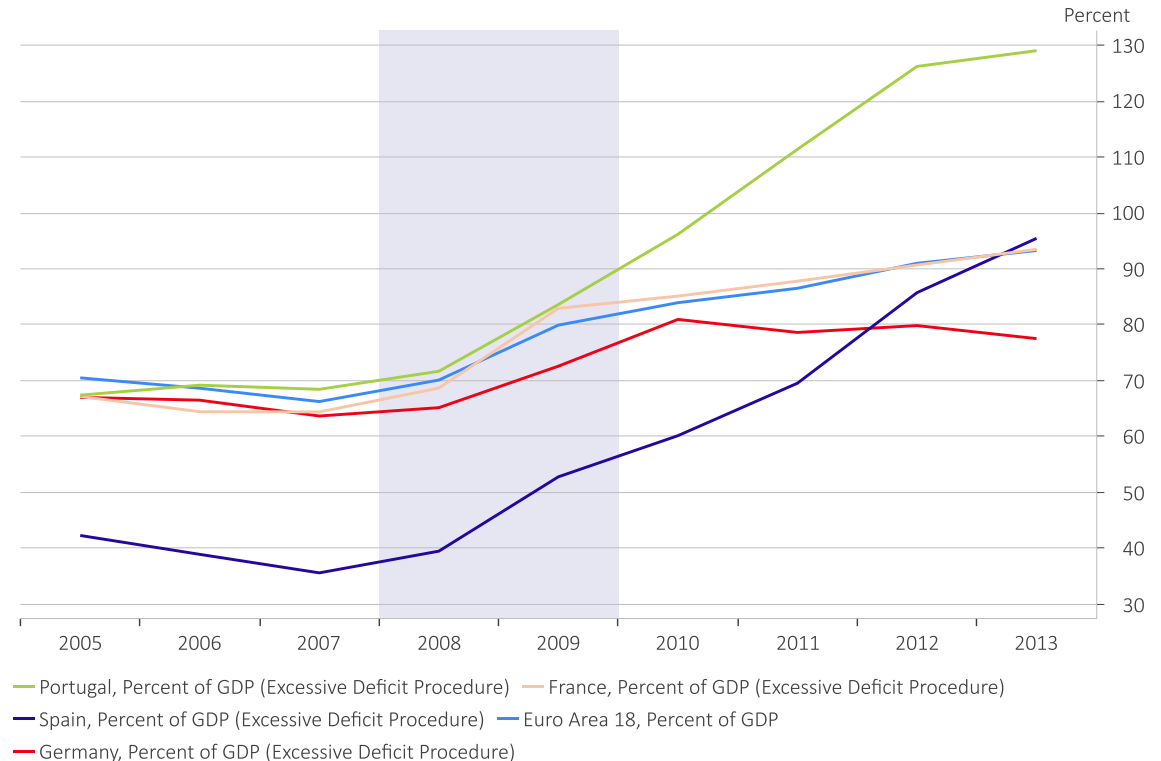
1. Excessive deficits in some countries (Greece!)
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- Lax regulation and excessive credit growth led to problems in a number of countries
 - During the US subprime crisis (2007-9)
 - Germany, France, Ireland, Belgium, Netherlands
 - Later, during the euro crisis
 - Spain, Greece, Cyprus

Crisis cause #2: Problems in the banking sector

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Gross Government Debt, in % of GDP

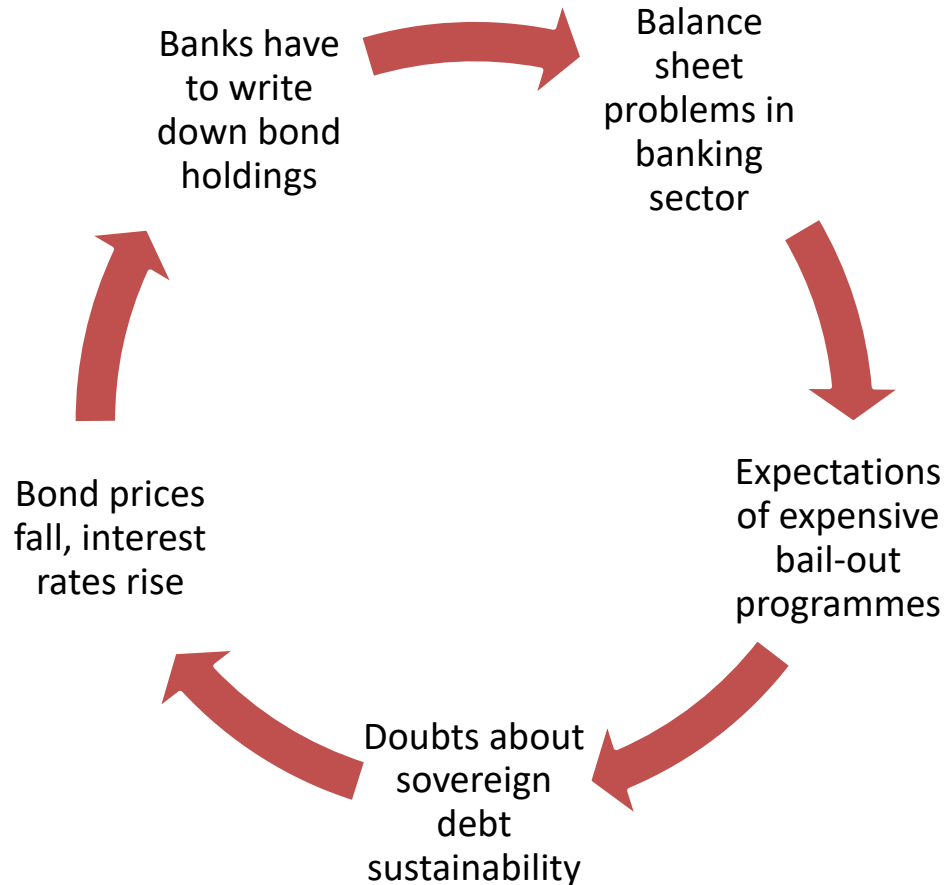


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Crisis cause #3: Doom-loop between banks and sovereigns

The crisis causes

1. Excessive deficits in some countries (Greece!)
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3. **Doom-loop between sovereigns and banks**
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Bank problems, sovereign debt sustainability and monetary integration

- Monetary integration makes problems in banking sector worse
 - With national oversight: External effects of insufficient oversight are not taken into account
 - Financial market integration leads to bigger banks
 - Concentration (Krugman's argument)
 - For smaller countries: larger market
 - „Too big to save“ becomes more likely

Crisis cause #4:

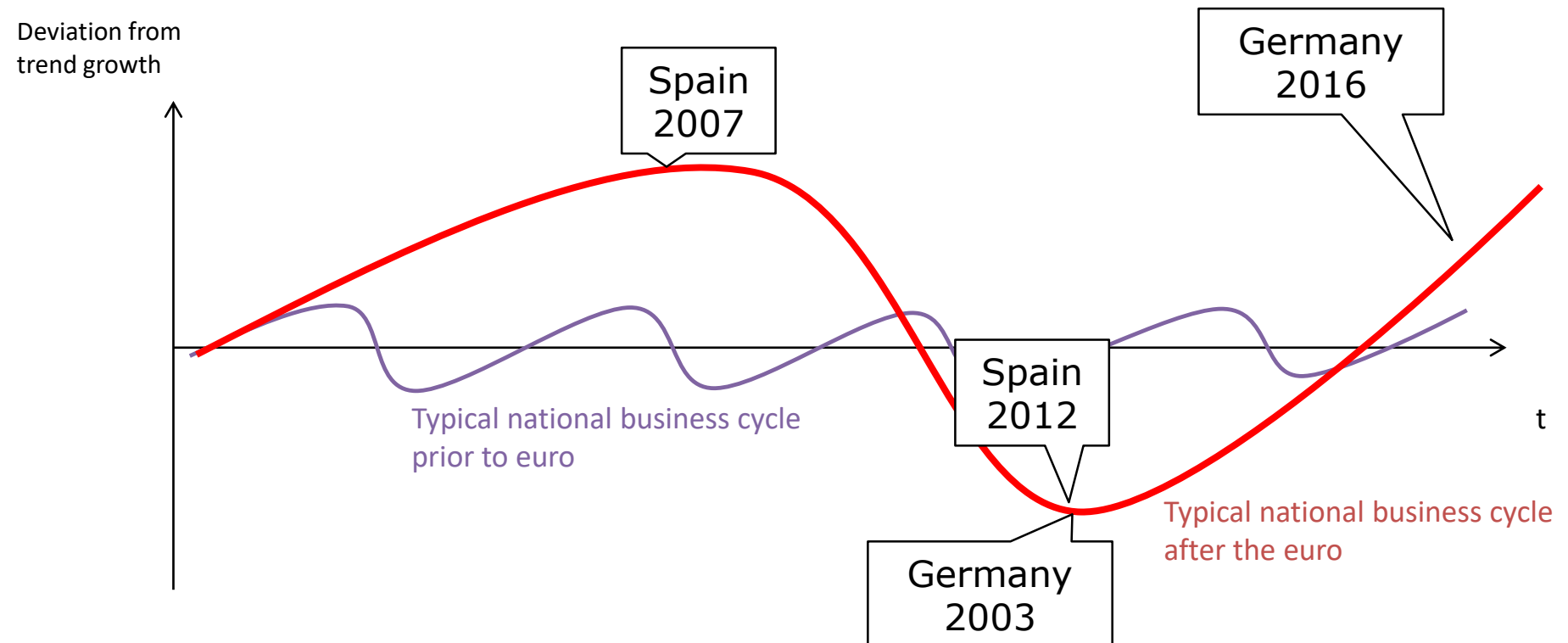
Self-fulfilling market panics

The crisis causes

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 4. **Self-fulfilling market panics**
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- Without lender-of-last-resort: Danger of self-fulfilling debt crises (Obstfeld 1996, Cole/Kehoe 1996)
 - With intermediate debt levels, multiple equilibria are possible:
 - If investors believe in solvency, interest rates remain low and country remains solvent
 - If investors doubt solvency, interest rate increases and country might be pushed into insolvency
 - Lender-of-last-resort can solve this problem
 - EMU has introduced „original sin“ through the back door

Crisis cause #5: Boom-and-bust-cycles

- Euro introduction prolonged and deepened cycle as national monetary policy was not available to dampen cycle anymore

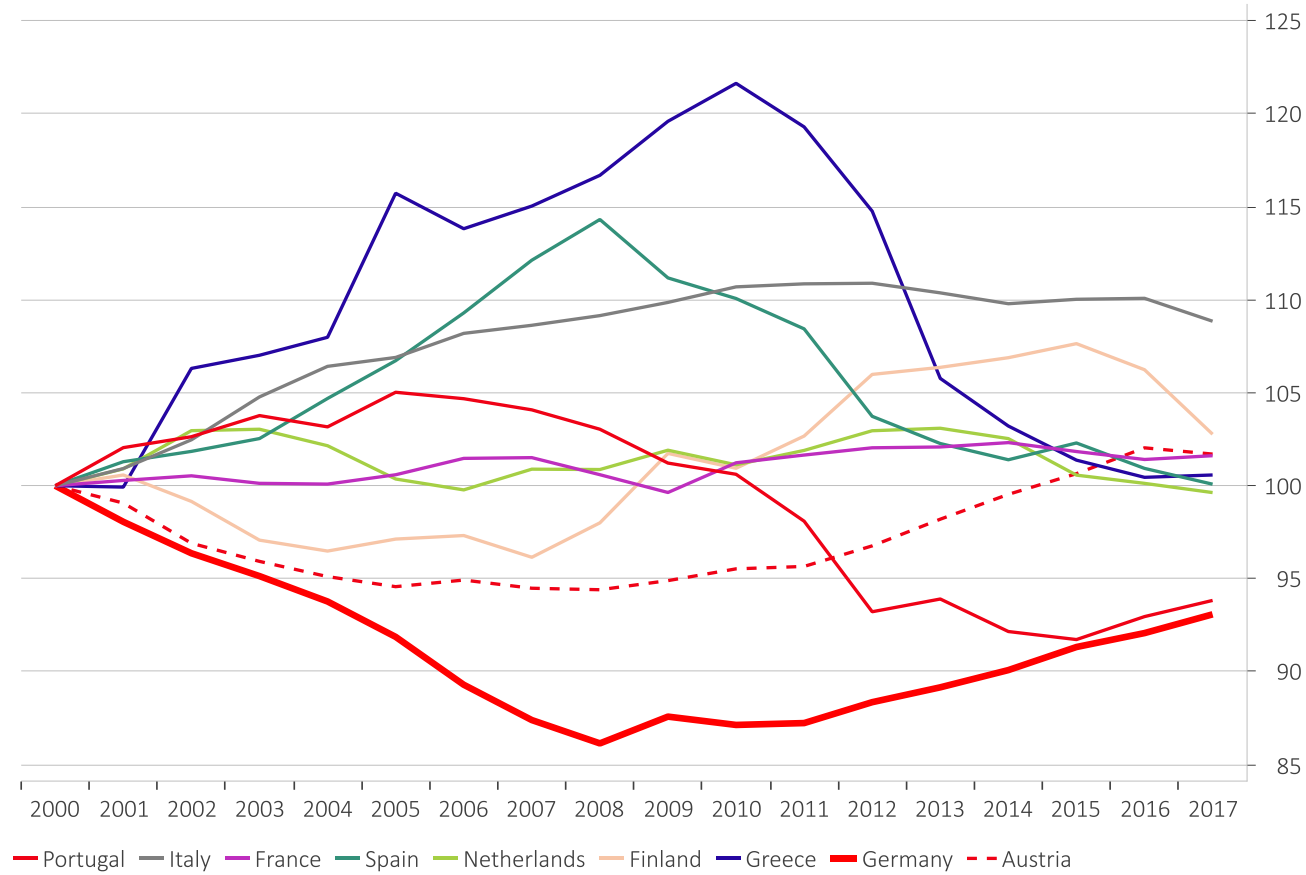


Crisis cause #6: Structural divergence of competitiveness

The crisis causes

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Relative Nominal Unit Labour Costs, 100=Euro Area



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Crisis cause #7: Interaction of political/financial market crisis

The crisis causes

1. Excessive deficits in some countries (Greece!)
 2. Problems in the banking sector
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 4. Self-fulfilling market panics
 5. Boom-Bust cycles in the periphery
 6. Structural divergence of competitiveness
 7. Loss of legitimacy because of dismal economic performance/feeling of political impotence
- Trust in the EU has eroded in many countries
 - Feeling is that EU/euro framework is forcing policies onto countries which are not wanted (and possibly not good)
 - Populists have gained in many countries
 - Danger: Interaction of populism & financial markets
 - Imagine populists promising a euro in/out referendum come close to power
 - This could trigger outflow of bank deposits
 - No proper tool available to counteract outflows

Crisis cause #7: Interaction of political/financial market crisis

The crisis causes

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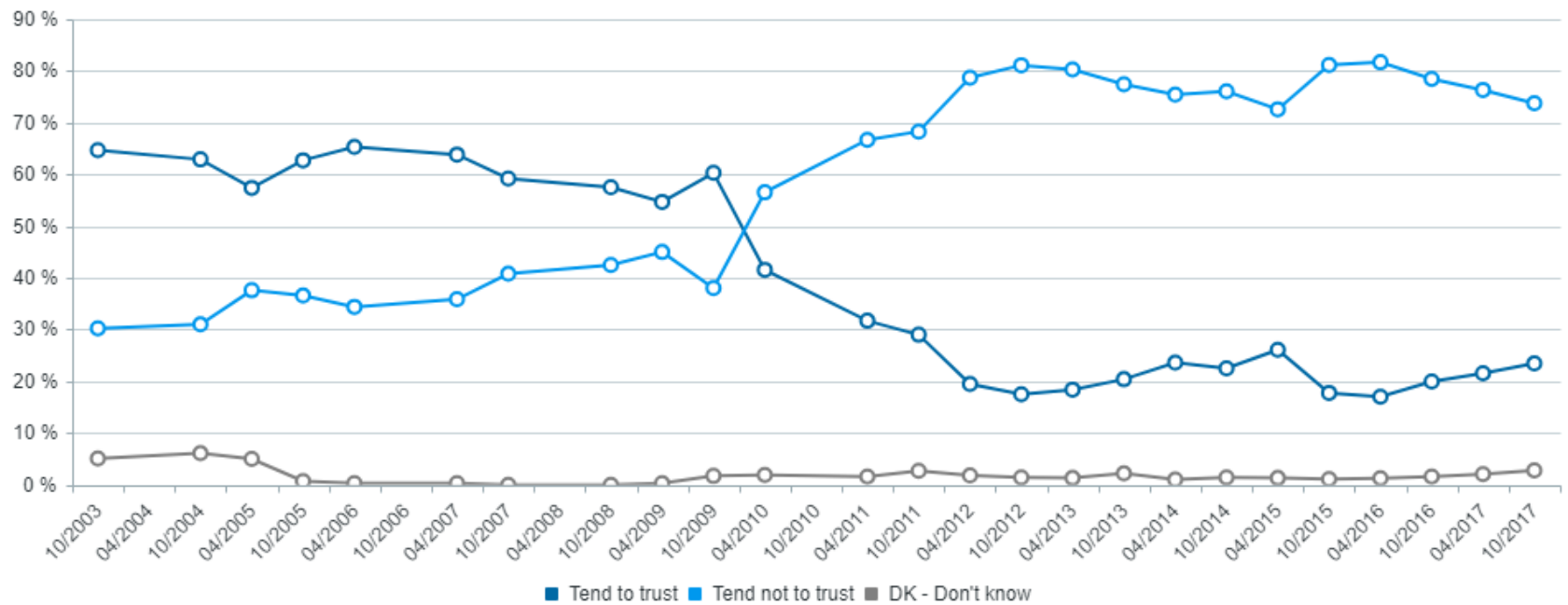
Italy, Government Benchmarks, 10 Year, Yield



Trust in the EU seems to be related with economic performance: Greece

I would like to ask you a question about how much trust you have in certain media and institutions. For each of the following media and institutions, please tell me if you tend to trust it or tend not to trust it.

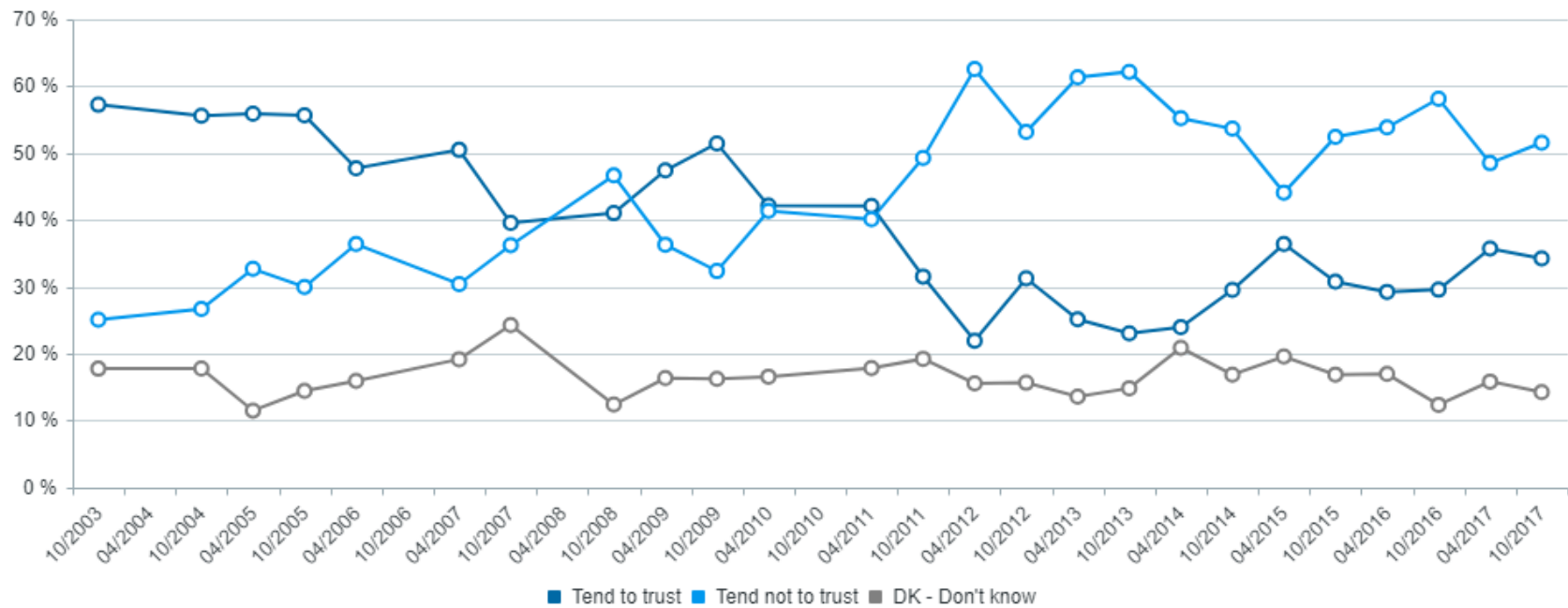
The European Union
Greece (from 10/2003 to 11/2017)



Trust in the EU seems to be related with economic performance: Italy

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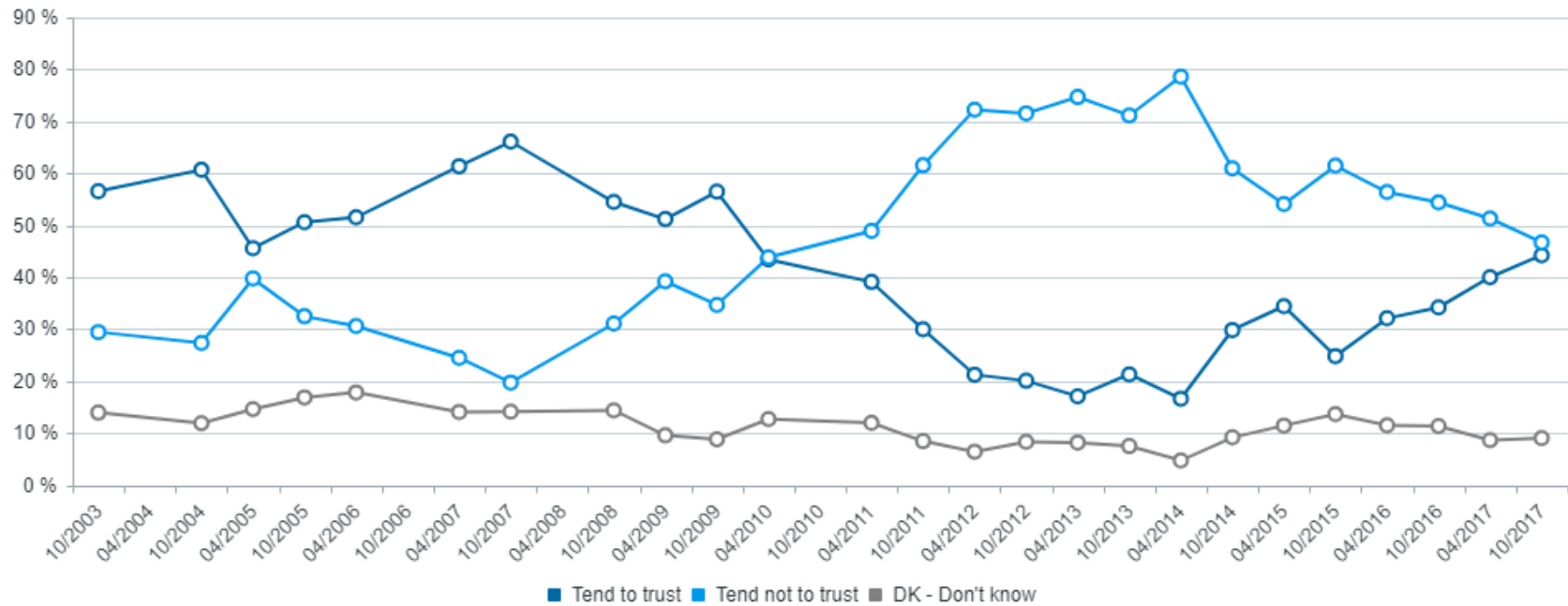
The European Union
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Trust in the EU seems to be related with economic performance: Spain

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The European Union
Spain (from 10/2003 to 11/2017)



Problems of legitimacy

People were promised...

- ...improved living standards
- ...more jobs
- ...creation of policy space at EU level to replace policy space lost at national level
- No transfer union (in the North)

People perceive outcome as..

- ...stagnating living standards
- ...high unemployment
- ...the troika implementing „neoliberal“ reforms against democratic will
- ...forced transfers to the South

In order to counter these feelings

- Euro area needs to prevent replay of last crisis
- Euro area needs to rekindle growth and job creation
- Euro area needs to show a social face
- Euro area needs to strengthen democratic rule and push back intergovernmentalism
- Overall, thus EMU/EU will be able to provide protection of the „European way of life“
- These measures might not win back all populist voters, but potentially those from the left

PRE-2017 REFORMS OF THE EURO-AREA

Euro area reforms so far

- Six Pack/Two Pack
 - Limiting deficits and debt
 - Preventive and corrective arm of SGP; macroeconomic imbalance procedure
- Fiscal compact
- ESM and OMT
- Banking union (but only partial)

Which problems were tackled by past reforms?

	Six Pack	Two Pack	Fiscal compact	ESM & OMT	Banking union
Excessive deficits	+	+	+		
Problems in the banking sector					?
Doom-loop between banks and sovereigns		Unresolved/partly resolved problems			?
Self-fulfilling fiscal crisis				+	
Boom-bust-cycles	?				
Diverging competitiveness	?	Unresolved/partly resolved problems			
Loss of legitimacy because of dismal growth performance		Completely unaddressed			

So, despite the reforms, euro-area
architecture still seems fragile

REFORM DEBATES AND PROGRESS SINCE 2017

Reform proposals since 2017 (I): EU Commission's „Saint Nicholas“-package

- Turn ESM into „**European Monetary Fund**“ & **fiscal backstop of banking union**
- Bring **fiscal compact** into EU treaties
- **(Small) budget element for Begrenztes Haushaltselement** zur Konjunkturstabilisierung & „Förderung von Reformen“
- Merge positions of president of eurogroup and vice president of EU Commission into a „**European Minister of Economy and Finance**“

New reform proposals (II):

14 GER-FR economists' paper

- **Common deposit insurance**
- **Backstop for Banking Union** at ESM
- **Capital market union**
- **New rules for government bonds in banks' balance sheets** („concentration charge“)
- **Creation of safe assets** in banking system („ESBies“)
- **Facilitating debt restructuring** („single limb aggregation“)
- **Automatic maturity extension for junior bonds** when ESM programme is triggered
- **Reform of fiscal rules:** expenditure path & junior bonds for excessive spending
- **Reform of ESM:** Enable ESM to act without IMK
- **New credit line** at ESM
- **Fiscal capacity** for €-area: Unemployment Reinsurance

New reform proposals (III): Macron's vision

- Eurozone budget
 - Several percent of GDP
 - Investments and joint projects such as European universities, research
 - Financing through tax revenue
 - Controlled by the EP
- Euro finance minister
- Increased cooperation in the realms of foreign and security policy, refugees, and external borders

New reform proposals (IV): Meseberg declaration

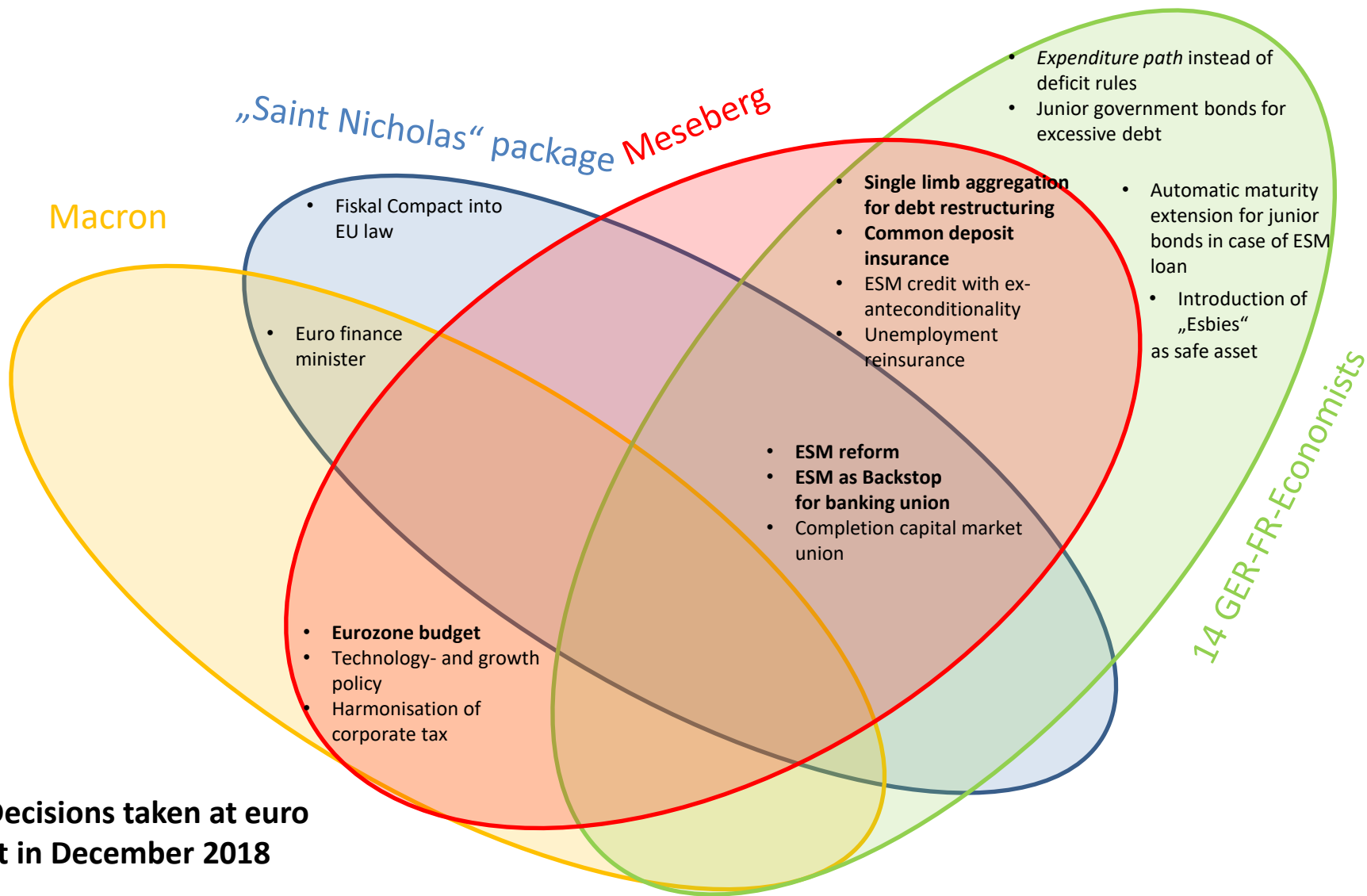
- **Reform of ESM:** Move into EU-treaty, more technical competence
- **New credit line at the ESM**
- **Eurozone budget** to promote „competitiveness and convergence “
- **European Unemployment Stabilization Fund**
- **Facilitating debt restructuring** („single limb aggregation“)

Scholz's proposal for a „European Unemployment (Re-)Insurance“

- Basic idea:
 - Each country contributes into national compartments
 - In crisis times, money is paid out
 - If compartment is empty, countries can borrow from other compartments
- Unclear whether there would be transfer elements (as in Dullien/von Weizsäcker 2018)

Decisions taken at euro summit in December 2018

- Facilitating debt restructuring („single limb aggregation“)
- ESM Reform
- ESM as Backstop for Banking Union
- Fiscal capacity for „competitiveness and convergence“
- Roadmap for negotiations of common European deposit insurance scheme



Bold: Decisions taken at euro summit in December 2018

EVALUATING THE REFORMS

Reform proposals and causes for crisis

	Bisherige Reformen	Nikolaus-Paket	14 Ökonomen	Macron	Meseberg	Beschlüsse Dezember '18
Excessive deficits	++		Expenditure rules with expenditure path			
Excessive debt level	?		New expenditure rules with junior debt		Single limb aggregation	Single limb aggregation
Problems in the banking sector	?	Completion of banking union	Completion of banking union	Completion of banking union	Completion of banking union	Backstop for banking union
Doom-loop between banks and sovereigns	?	Completion of banking union	Completion of banking union; Concentration charge for government bonds; Esbies	Completion of banking union	Completion of banking union	
Self-fulfilling fiscal crisis	+					
Boom-bust-cycles	?	Capital market union	Capital market union	Eurozone budget	Eurozone budget, European unemployment Reinsurance	
Diverging competitiveness	?			Technology- and growth policy	European investments	Marginal budget
Loss of legitimacy because of dismal growth performance				Euro finance minister; euro taxes; technology and growth policy	Tax harmonisation; taxation of digital companies	

02.08.2019

Conclusions

- The first round of reforms (since 2009) has made euro-zone more resilient, yet vulnerabilities remain
- Progress since 2017 has been disappointing
 - there is only a road-map for the common deposit insurance
 - the euro-budget will be marginal and only as part of the multiannual financial framework (EU budget)
 - there is no proper fiscal stabilization function

Open Question: How will the new European Commission act?

- Ursula von der Leyen has made bold promises, including pushing a European Unemployment Reinsurance
- Will she be willing/able to deliver?

**THANK YOU VERY MUCH FOR YOUR
ATTENTION**