Working Group Economic and Financial Affairs

Workpackage III: Economic and Financial Policy

Agenda

Thursday 10th May 2012
16.00 – 17.30 h
Fondation Universitaire, Rue d'Egmont 11
Salle Emile Francqui

"Over at last? Prospects for restoring economic stability in the eurozone and the EU"

Outline:

Financial, economic and sovereign debt crises have called into question macro-economic and monetary integration in Europe in general and the future of the eurozone in particular. Despite of some recent signs of improvement, worries over an EMU with high debt are still prevalent. At the same time, the consequences of reforms agreed in response to the crises are only gradually becoming visible. Hence, the Working Group's aim is to discuss the new governance framework from an economic perspective, highlighting linkages to the polical and social spheres and identfying the prospects and possible challenges for an "economic Union out of necessity".

Chair:

Andras Inotai, Institute for World Economics, Budapest

Introductory Statements:

Cinzia Alcidi, Centre for European Policy Studies, Brussels
Iain Begg, London School of Economics
Zsolt Darvas, Bruegel, Brussels

Discussion

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Report

Andras Inotai (Institute for World Economics, Hungarian Academy of Sciences) welcomed participants and introduced the topic of the workshop. He described the present situation as "management of costs of managing the crisis".

Subsequently, *Iain Begg* (London School of Economics) recalled the beginnings of the present crisis in 2007, when European Central Bank president Trichet first attempted to react to the imbalances in the banking system, and in 2009, when Greek Prime Minister Papandreou had to publish new figures on the public deficit of Greece. Against the background of the failure of politicians to tackle the problems in earnest, Professor Begg argued that there was a widespread impression – especially in the US – that EU leaders had shown themselves as incapable of solving the crisis (although Europeans would answer to this charge sheet that US banks were the first cause of the crisis). Against the background of the wider problem of pervasive debt on both sides of the Atlantic, he recalled that the central banks' poliy responses (Quantitative easing in the US, Long term refinancing operations in Europe) by ECB and Federal Reserve was rather similar in terms of their effects. He continued by pointing to a number of issues ahead, such as risks to the Spanish banking system, the flight in financial markets from yields to return of capital, judicial challenges to the agreed bail-out schemes before national constitutional courts (e.g. Karlsruhe), Political gridlock over the future crisis resolution strategy, and flawed arithmetic of the agreed rescue and austerity packages. Regarding governance, he opined that there would be benefits from the agreed reforms when normal times return, but at the present stage they would not be of much use. He concluded by underlining one of the most striking aspects of the crisis: former red lines were turning yellow, for example for the German government on Eurobonds.

In her introductory remarks, *Cincia Alcidi* (Centre for European Policy Studies Brussels) focused on "Economic Stability" and argued that such stability was imperative for the single monetary policy to work. Arguing that the eurozone's regulatory system still attributes zero risk to government debt, she addressed the proposal of creating a lender of last resort for the eurozone. In her view, the ECB would be best-placed to play the role of lender of last resort. She concluded by discussing a number of further reform proposals for the eurozone: (i) the red bonds/blue bonds variant of Eurobonds, (ii) full Eurobonds and (iii) fiscal/political union.

Zsolt Darvas (Bruegel) subsequently discussed structural divergences within the euro area, focusing on prices, wages, and investment. He recalled that the external balance of the euro area as a whole was more or less balanced (in contrast to the positions of individual countries and the US). With a view to the banking system, he argued for a more centralized system of oversight, given that the system was very integrated. He added that ¾ or 300 bn € of bank rescue funds had been spent in Germany, making German banks the largest group of beneficiaries of such assistance. Describing that the role of the ECB would be greatly diminished if Eurobonds were introduced, he made reference to the alternative proposal of a "Debt Redemption Fund" made by the German Council of economic wise men. In his view, Eurobonds would only be a realistic concept in the medium term if there were a surge in bond yields, for example if a large country such as Italy faced a major crash.

In the general discussion, *Brigid Laffan* (University College Dublin) highlighted the importance of the policy mix Germany as the "swing state" would pursue. *Ron Holzhacker* pointed to the US, where states such as California also had to by higher interest rates for their debt, but could rely on federal taxes. In response, Cinzia Alcidi questioned the rationale of a growth pact at EU level, underlining that all the infrastructure spending in the southern states had not had much positive effects. Demand-side economics, especially in Germany, seemed to be a better strategy.

Louise van Schaik (Clingendael Institute, The Hague) questioned the idea of an explicit lender of last resort, arguing that the crisis had been caused by banks that operated under the illusion of an implicit bailout. *Iain Begg* responded that in the end it depends on what Germany is willing to do. The fiscal compact might allow them to look the other way if French President Hollande embarked on demand-side economics. He highlighted unemployment as the coming problem.

Sigurbjörg Sigurgeirsdóttir (University of Iceland) expanded on the Icelandic banking crash and asked whether a firewall between investment banking and commercial banking could be enforced by the EU. Iain Begg answered in the negative, saying that this still was a national competence.

Marijan Svetlitic (University of Iceland) turned again to the issue of competitiveness between member stateswas still not sufficiently addressed in the EU.

Andras Inotai concluded by returning to the subject of economic vs. political reality. In the end, reforms would be determined not on their economic viability, but to a large extent also on electoral cycles.

Tobias Kunstein (University of Cologne)