The First Two European Semesters: PKSG Workshop SOAS June 7th 2013

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The Russian Questions

Who is responsible?

What is to be done?

Who is responsible? The boom

Commission Responsibility in the Financial Crisis

Liikanen Report:

The crises also highlighted the danger of putting market integration first and building policy integration later. (p67)

Down with transactions costs:The Stockholm Council

“Business and citizens in the European Union need a regulatory environment which is clear, effective and workable in a rapidly changing, global market place. This is a key element if the European Union is to become the **cheapest and easiest place** to do business in the world.”

European Commission (2001) Realising the European Union’s Potential: consolidating and extending the Lisbon Agenda, Contribution of the Commission to the spring European Council, Stockholm, 23rd-24th March, 2001, Brussels. **Emphasis in the original.**

Lamfalussy Committee, draft report

‘…greater efficiency does not necessarily go hand in hand with enhanced stability….Increased integration of securities markets entails more interconnection between financial intermediaries on a cross-border basis, increasing their exposure to common shocks….there is an urgent need to strengthen cooperation at the European level between financial market regulators and the institutions in charge of micro and macro prudential regulation.’

Commission Responsibility in the Financial Crisis

Alexandre Lamfalussy (2003): ‘It was politely but firmly suggested that we drop the subject.’

Creating an Integrated European Market for Financial Services, in P. Booth and D. Currie (eds) The Regulation of Financial Markets (London: IEA) pp. 105-120.

DG Internal Market: the hooligans

Green Paper on Mortgages, 2005:

‘Many….. express the view that the further integration of the EU mortgage markets could be considerably enhanced by the emergence of a panEuropean funding market’ (p13).

DG Internal Market: the hooligans

US experience suggests that –

Legal or other restrictions to banks’ geographical expansions will reduce the efficiency of the mortgage-lending industry.

Steps to create a single EU mortgage market would increase incentives to develop automated systems to process loan applications, which would reduce origination costs.

Removing restrictions on maximum mortgage interest rates would **allow a subprime mortgage market to develop**, thus expanding total mortgage lending.

(London Economics:168, emphasis added)

Hooligans: White Paper on Mortgages, December 2007

A breathtaking assertion:

‘recent events in global mortgage markets have confirmed the pertinence of the approach proposed’ (p10).

Leveraging Europe

Hooligans press release (27/2/2008):

> European banks are well capitalised: ‘The origin of the current financial turmoil came from the US sub-prime mortgage sector and a large portion of the European financial sector is not directly affected by the turmoil at this stage. Where financial institutions have sizeable direct exposures to the US sub-prime market, or indirect exposures through structured products, the affected entities have well diversified portfolios and large capital buffers.’

The Reality

“The most shocking news from last week’s excellent Global Financial Stability Report from the International Monetary Fund was not the headline estimate of total bad assets. That number stands at $4,100bn (£2,800bn, €3,000bn) and will almost certainly be revised upwards. Much more shocking was that the lion’s share of these assets belong to European, not North American, banks. Of the total $4,100bn, the global banking system accounts for $2,800bn. Of that, a little over half – $1,426bn – is sitting in European banks, while US banks account for only $1,050bn……….

………...You get the picture. All these data tell us that Europe has both the biggest problem and has made the least progress.”

Wolfgang Münchau, *Financial Times*, 26th April, 2009

One could go on…..

For example, the Commission’s attack on consumer protection in retail finance……...

For example, the draft takeover directive.....

The failure of crisis management:who is responsible?

Aglietta and Brand on the three big failures:

Un New Deal pour l'Europe: croissance, euro, compétitiveté,

Odile Jacob, Paris, 2013

No clean-up of banking

1) “There was no determination by the member states to clear up the banking system, contrary to the management of the banking crisis in Sweden and Finland in the 1990s. There were certainly differences across countries but the conditions attached to government interventions were on average hardly restrictive and hardly constraining on the quality of bank balance sheets. The process of winding down these balance sheets will in consequence be all the more prolonged” (p133)…. the eurozone's failure to impose losses, make the banks write down impaired assets and recapitalise on a large scale threatens stagnation on the pattern of Japan in the 1990s rather than rapid recovery as in the nordics at the start of the 1990s.

Failure to isolate Greek crisis

2) "Secondly, the case of Greek public finance should have been kept specific to that country instead of contaminating the financial markets as a whole and weakening the banks. This was a double error because it involved on the one hand the inability of the markets to distinguish liquidity risks from solvency risks (assisted by the ratings agencies which mark the ratings of sovereign debtors down for any reason with no scientific legitimacy) and, on the other hand, the incapacity of political leaders to come to agreement on a partial default at the beginning of 2010. A vicious interaction between sovereign risks and banking risks then developed" (p133/4).

Fiscal adjustments too fast

3) “Thirdly, the budgetary adjustments put in place today are too fast. In fact, fiscal multipliers are higher to the extent that economic agents are trying to pay down their debts and are subject to tighter constraints on their borrowing, that unemployment is high and that the key interest rates set by the central bank are close to zero. All the conditions have come together to make the present budgetary adjustments extremely harmful to activity and employment and to produce the result that, in spite of the reductions in deficits, public debt only decreases by very small amounts” (p134).

Who is responsible? The bust

Discipline and punish:

The six-pack (and the scorecard)

The two-pack

The Pact for the euro

The fiscal compact

The Six-pack

New Definitions of “Excessive” Debts and Deficits

- Stronger surveillance
- Reinforced Penalties
- Specification of Fiscal Framework in Member States
- Introduction of an “Excessive Imbalance” Procedure
- Penalties Attached to “Excessive Imbalances”

All these are regulations except 3. Items 1,2 (in part),4,5 apply to all members. Penalties only to the Eurozone members.

The Scoreboard

- 3 year backward moving average of the **current account balance** as percent of GDP, with a threshold of +6% of GDP and -4% of GDP;
- **net international investment position** as percent of GDP, with a threshold of -35% of GDP;
- 5 years percentage **change of export market shares** measured in values, with a threshold of -6%;
- 3 years percentage change in **nominal unit labour cost,** with thresholds of +9% for euro-area countries and +12% for non-euro-area countries;
- 3 years percentage **change of the real effective exchange rates** based on HICP/CPI deflators, relative to 35 other industrial countries, with thresholds of -/+5% for euro-area countries and -/+11% for non-euro-area countries;

The Scorecard (continued)

year-on-year changes in house prices relative to a Eurostat consumption deflator, with a threshold of 6%;

private sector debt in % of GDP with a threshold of 160%;

private sector credit flow in % of GDP with a threshold of 15%;

year-on-year changes in house prices relative to a Eurostat consumption deflator, with a threshold of 6%;

general government sector debt in % of GDP with a threshold of 60%;

3-year backward moving average of unemployment rate, with a threshold of 10%.

The Two-pack

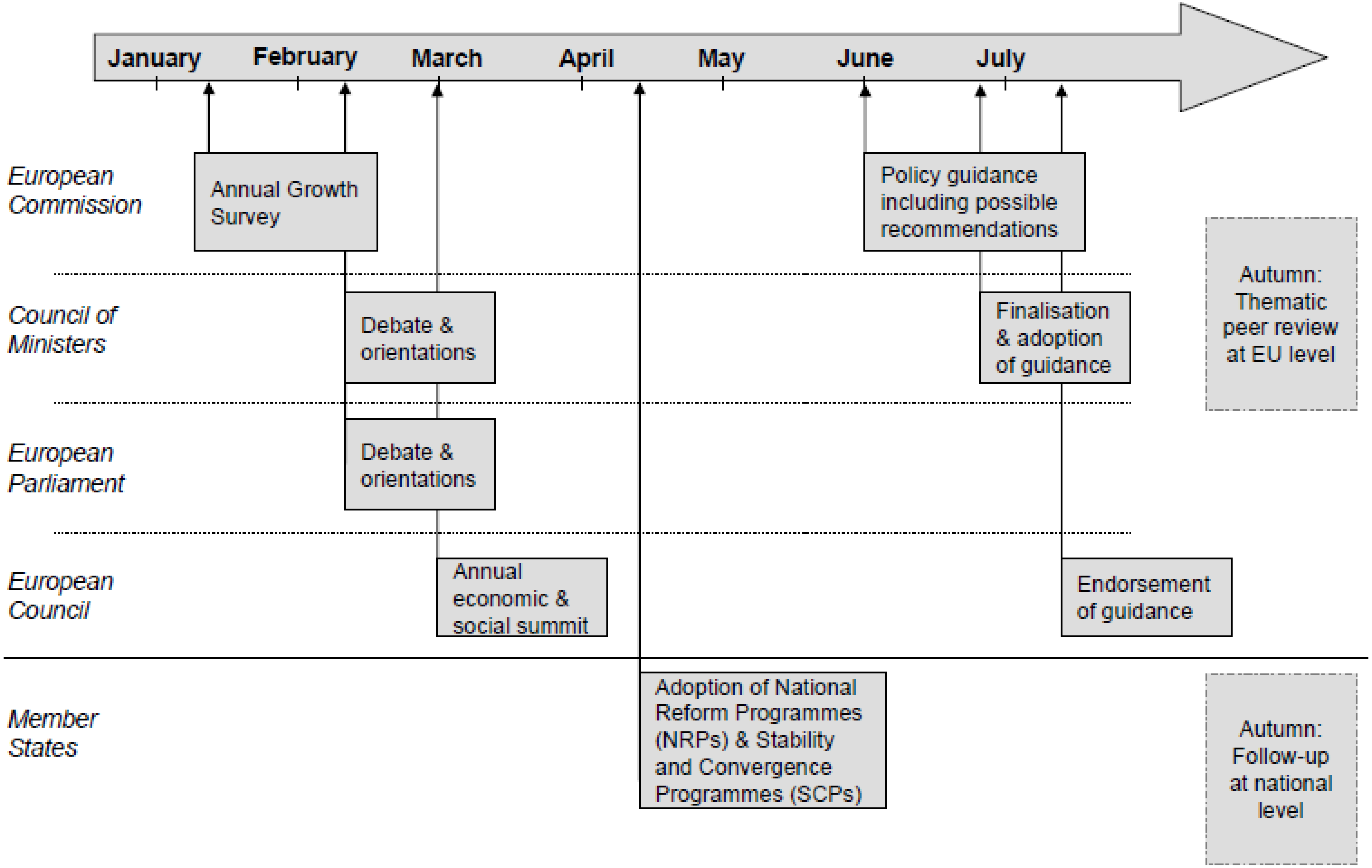
Submission of national budgets to Commission; right of the latter to propose changes. Requirement for independent bodies in charge of monitoring national fiscal rules and budgetary forecasts based on independent macroeconomic forecasts.

For euro area Member States in EDP, a system of graduated monitoring is established in order to secure a timely and durable correction of excessive deficits and to allow an early detection of risks

The Fiscal Compact (Treaty on Stability, Coordination and Governance)

Specifically, the Fiscal Compact requires Member States to enshrine in national law a balanced budget rule with a lower limit of a structural deficit of 0.5% GDP, centered on the concept of the country-specific medium-term objective (MTO) as defined in the SGP. The Fiscal Compact’s provisions also increase the role of independent bodies, which are given the task of monitoring compliance with the national fiscal rules, including the operation of the national correction mechanism in case of deviation from the MTO or the adjustment path towards it (also included in the Two Pack).

European semester of policy coordination


January
February
March
April
May
June
July
European Commission
Council of Ministers
European Parliament
European Council
Member States
Annual Growth Survey
Debate & orientations
Debate & orientations
Annual economic & social summit
Adoption of National Reform Programmes (NRPs) & Stability and Convergence Programmes (SCPs)
Policy guidance including possible recommendations
Finalisation & adoption of guidance
Endorsement of guidance
Autumn: Thematic peer review at EU level
Autumn: Follow-up at national level

11/28/12

Two main points

Surveillance without coordination

Frontal assault on the social models

Growth Rates as per Stabilisation Plans Spring 2011

GDP

Country	2010	2011	2012	2013	2014
Euro area (17 countries)	9161.695				
Belgium	354.3775	2	2.3	2.1	2.3
Germany	2476.8	2.3	1.8	1.5	1.5
Estonia	14.30526	4	4	3.6	3.6
Ireland	155.9923	0.3	2	2.5	2.5
Greece	227.3179	-3.5	0.8	2.1	2.1
Spain	1051.342	1.3	2.3	2.4	2.6
France	1932.802	2	2.25	2.25	2.25
Italy	1556.029	1.1	1.3	1.5	1.6
Cyprus	17.3336	1.5	2.5	2.7	3
Luxembourg	40.2669	3.2	3.5	3.7	4
Malta	6.16365	2.4	2.3	2.6	2.8

Forecast and actual GDP growth, 2011

	SPs	Outcome
Belgium	2	1.9
Germany	2.3	3
Estonia	4	7.5
Ireland	0.3	0.9
Greece	-3.5	-6.8
Spain	1.3	0.7
France	2	1.7
Italy	1.1	0.2
Cyprus	1.5	0.5
Luxembourg	3.2	1.1
Malta	2.4	2.1
Netherlands	1.8	1.2
Austria	2.5	3.1
Portugal	-2.2	-1.5
Slovenia	1.8	0.3
Slovakia	3.4	3.3
Finland	3.6	2.7

2012 GDP Growth Rates (%)

SPs and Latest Commission Forecasts

	SP	Commission
Belgium	2.3	0.9
Germany	1.8	0.8
Estonia	4.0	3.2
Ireland	2.0	1.1
Greece	0.8	-2.8
Spain	2.3	0.7
France	2.3	0.6
Italy	1.3	0.1
Cyprus	2.5	0.0
Luxembourg	3.5	1.0
Malta	2.3	1.3
Netherlands	1.5	0.5
Austria	2.0	0.9
Portugal	-1.8	-3.0
Slovenia	2.2	1.0
Slovakia	4.8	1.1
Finland	2.7	1.4
Eurozone	**1.8**	**0.5**

The Export Surge

Contribution of Net Exports to GDP growth (%)

	2011	2012	2013	2014
Belgium	0.5	0.2	0.4	0.4
Germany	0.4	0.1	0.0	0.0
Estonia	0.9	0.0	-0.3	-0.5
Ireland	3.0	2.6	2.3	2.1
Greece	2.7	2.5	1.4	0.7
Spain	1.3	1.0	0.7	0.6
France	-0.1	-0.1	-0.1	-0.1
Italy	0.0	0.0	0.0	0.0
Cyprus	0.2	0.5	0.7	0.8
Luxembourg	0.2	0.4	1.0	1.0
Malta	0.3	1.7	1.3	1.6
Netherlands	0.8	0.5	0.3	0.3
Austria	1.0	0.6	0.5	0.5
Portugal	4.0	3.1	1.6	1.1
Slovenia	1.5	0.7	1.0	1.0
Slovakia	[illegible]	[illegible]	[illegible]	[illegible]

Overall Implications

Since aggregate net exports must be exports outside the zone, we see that the SPs imply a very strong export surge to the rest of the world. Over the period of the SPs this sums to €128 billion (at 2010 prices) and would lift the zone’s net exports from 1.3% of GDP in 2010 to 2.5% by 2014.

Actual External Exports

External trade of eurozone (% of GDP)

	Exports	Imports	Net Exports
2009	19.89	19.10	0.79
2010	22.69	22.05	0.64
2011	24.52	23.82	0.70

ECB Monthly Bulletin, March 2012

Net Exports: Implications of SPs

	2010	2011	2012	2013	2014
Ezone netX	115.50	167.44	201.69	224.33	243.62
Ezone GDP	9161.70	9312.99	9484.64	9662.69	9851.22
netXshare (%)	1.3	1.8	2.1	2.3	2.5

Who has external exports?

Not Greece, Spain, Italy or Portugal

	Extra Exports/GDP
Belgium	21.7
Germany	15.3
Estonia	19.2
Ireland	23.6
Greece	2.7
Spain	5.7
France	8.0
Italy	9.3
Cyprus	2.1
Luxembourg	21.7
Malta	16.0

Blanchard and Leigh on the Fiscal Multiplier

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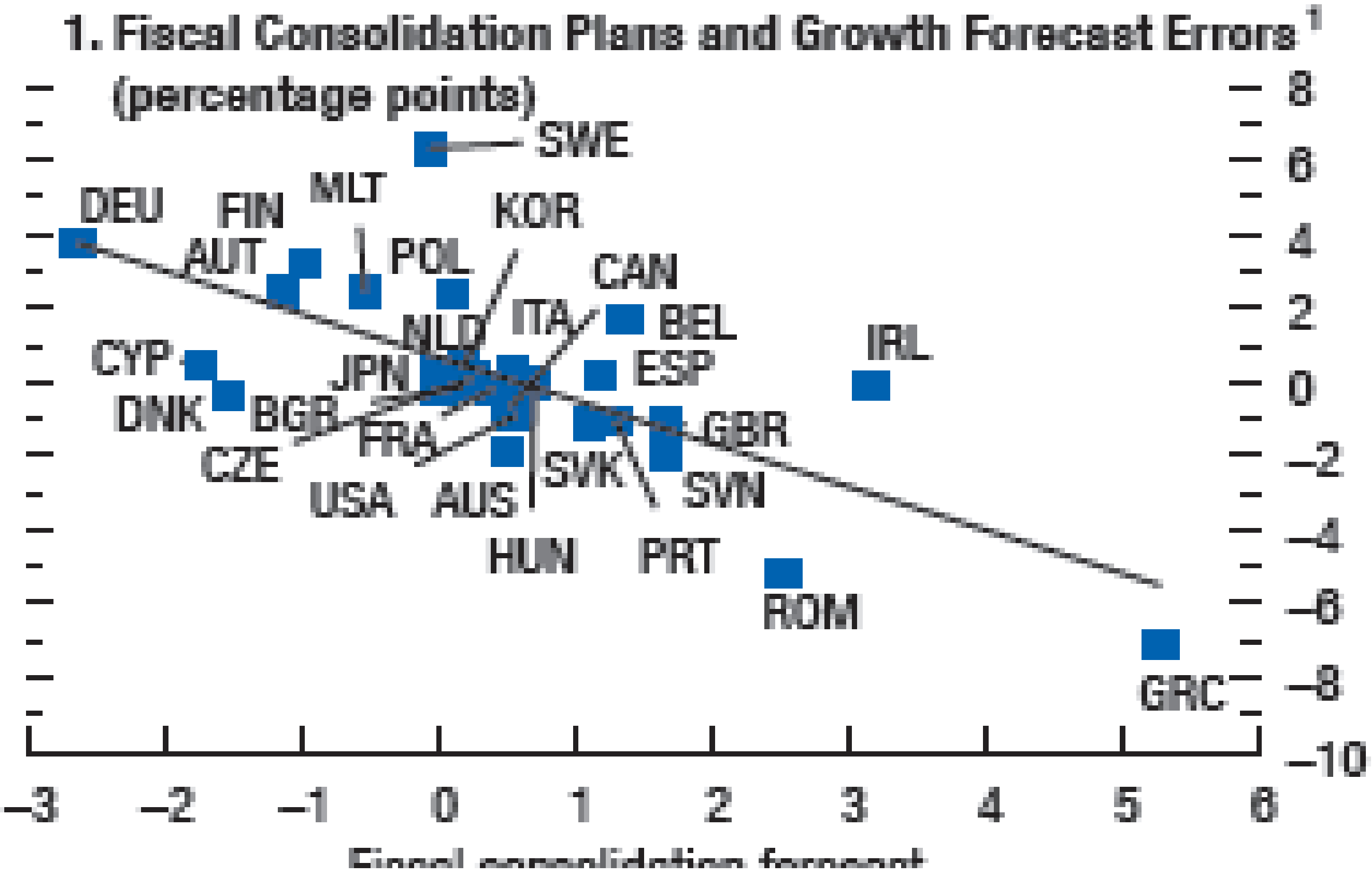


1. Fiscal Consolidation Plans and Growth Forecast Errors[1]
(percentage points)

2012 SPS: no change

Eurozone Unemployment Rates (%)

	2011	2012	2013	2014	2015
eurozone	10.1	10.8	10.7	10.5	10.2

Life in the debtors’ prison

- Greece: MoU is a totalitarian document:

“**Prior to the first disbursement of the new programme** …………

Reduction in pharmaceutical expenditure by at least EUR 1 076 million, in 2012 by reducing medicine prices (generics and branded medicines), increasing copayments, reducing pharmacists' and wholesalers' trade margins, application of compulsory e-prescription by active substance and protocols, the update of the positive list of medicines and the implementation of a mechanism of quarterly rebates (automatic claw-back) to be paid by the pharmaceutical industry.

Reduction in the number of deputy mayors and associated staff with the aim of saving at least EUR 30 million.

Reduction in the central government's operational expenditure, and election-related spending, by at least EUR 270 million, compared to the budget.

Frontloading cuts in subsidies to residents in remote areas, and cuts in grants to several entities supervised by the several ministries, with the aim of reducing expenditure in 2012 by at least EUR 190 million.

Article 21

Operations with public entities

21.1. In accordance with Article 123 of the Treaty on the Functioning of the European Union, overdrafts or any other type of credit facility with the ECB or with the national central banks in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the ECB or national central banks of debt instruments.

What is to be done

- European union must assume its responsibilities.

Banking Union is both crisis management and long-term institutional construction

Burden of re-capitalisation moved from peripheral governments to the EU.

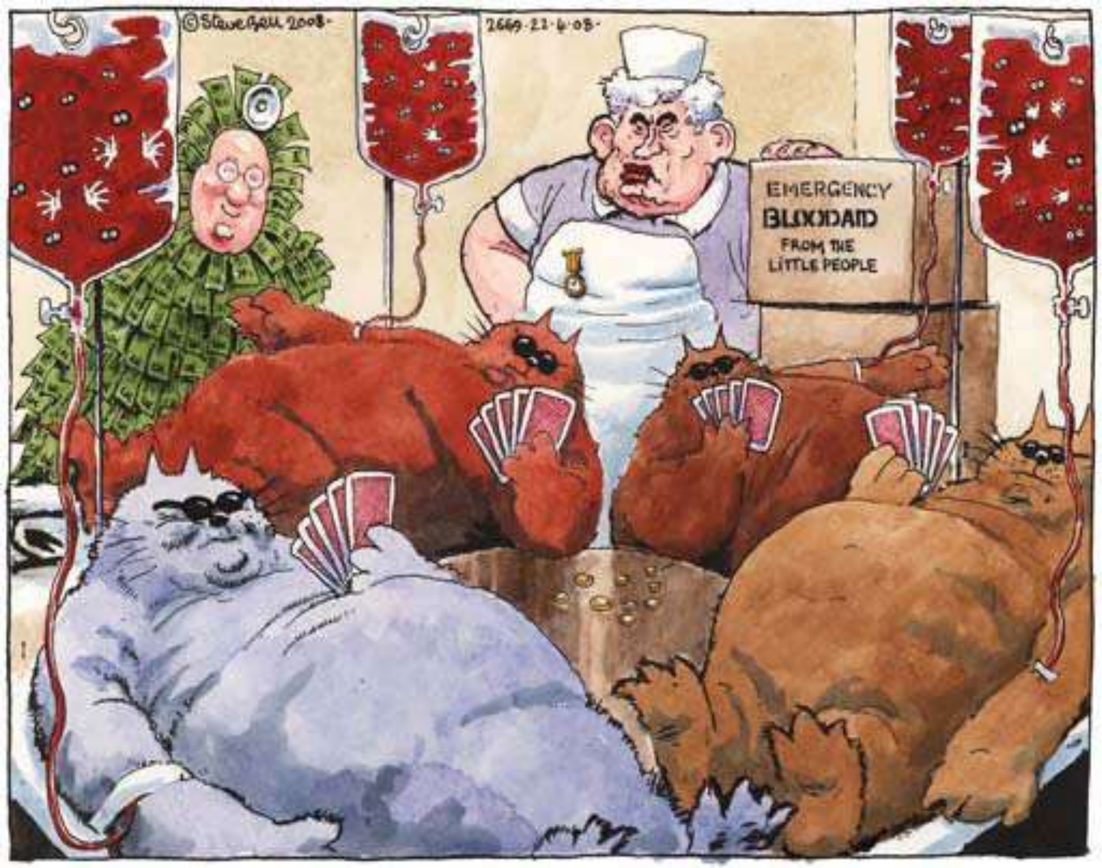
Restructuring of sovereign debt less disruptive of payments systems and credit supply (big problems would remain, in particular with pension funds).

Wolfgang Schäuble: Lord, give me a banking union, but not yet

“A two-step approach could start with a resolution mechanism based on a network of national authorities as soon as the new supervisor is operational, the resolution directive has been adopted and the Basel III capital requirements are in place.

Instead of a single European resolution fund – which the industry would take many years to fill – such a model would lean on national funds, which already exist in several member states.”

Helping the Banks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FROM THE
LITTLE PEOPLE

Germany: rescue of German banks (IMF wp/12/163)

Germany: rescue of German banks (IMF wp/12/163)

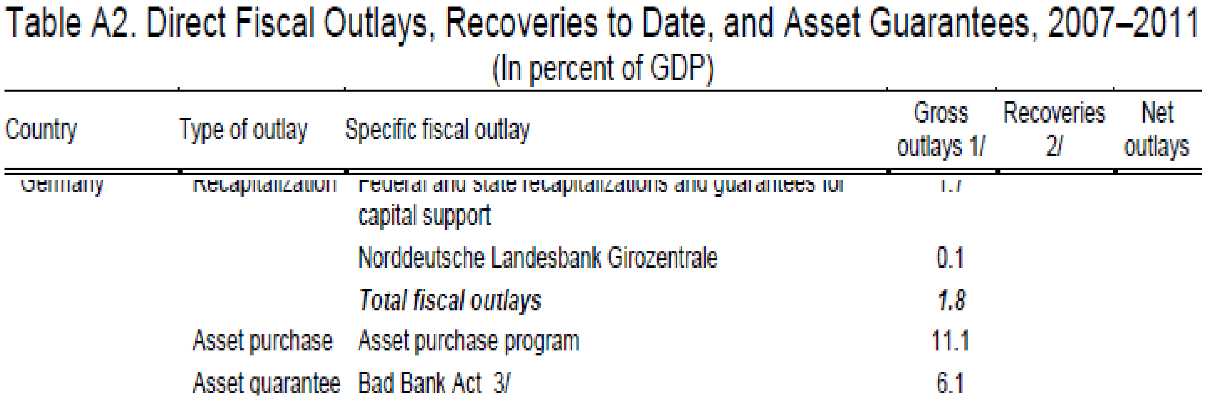
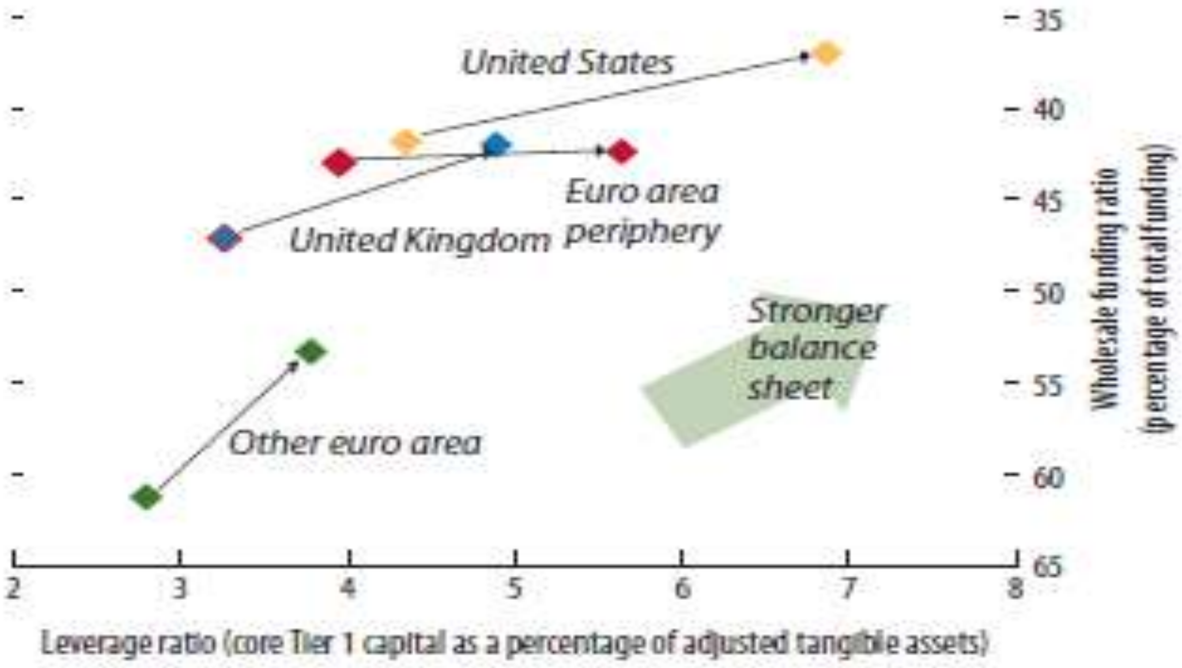


Table A2. Direct Fiscal Outlays, Recoveries to Date, and Asset Guarantees, 2007–2011

(In percent of GDP)

Country	Type of outlay	Specific fiscal outlay	Gross outlays 1/	Recoveries 2/	Net outlays
Germany	Recapitalization	Federal and state recapitalizations and guarantees for capital support	1.7		
		Norddeutsche Landesbank Girozentrale	0.1		
		Total fiscal outlays	*1.8*		
	Asset purchase	Asset purchase program	11.1		
	Asset guarantee	Bad Bank Act 3/	6.1		

Figure 1.33. Bank Leverage and Wholesale Funding Ratios, 2008:Q4 to 2012:Q3



IMF: no level playing field for eurozone corporations

- *Some banks in the euro area periphery remain challenged by deleveraging pressures, still-elevated funding costs, deteriorating asset quality, and weak profits. Corporations in the periphery are directly affected by bank deleveraging, cyclical headwinds, and their own debt overhangs. Against this backdrop,more work needs to be done in the short term to improve bank and capital market functioning, while moving steadily toward a full-fledged banking union.*

Wolfgang Münchau on banking union

- Comprehensive
- Retrospective

Problems of banking structure

The two mantras (Charles Goodhart)

1) If it's too big to fail it's too big;

2) We must separate the public utility from the casino.

Problem of scale impossible to address prior to a functioning banking union

New constraints on banks are likely to promote securitisation.

Two Priorities

1) Stronger capitalisation (and removal of these problems from the debtor states).

2) Strong defence of retail investors (standardisation of products, limits to charges)

Total Incoherence of the FTT

1) Will tax repos but not FX swaps - won’t this make the euro money market totally dependent on liquidity conditions in the US?

2) Massive impact on money market mutuals

3) Why not tax the assets of all actors in the financial sector?