

EU-crisis: Lessons for a changing EU?

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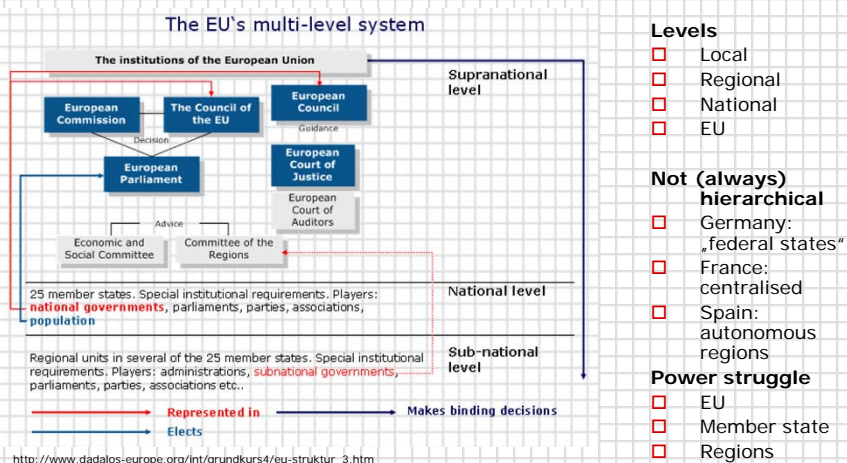
- **Question: Is a re-design of the EU needed and feasible?**
 - If yes: Would „More Europe“ be a solution?
 - Centralisation, supra-national (= „common“; community method)
 - **Steps to an answer**
 - Power and assignment of tasks: local-national-EU
 - What should EU do? (Criteria)
 - What does EU do? (Facts)
[Economic and Monetary Union EMU]
 - **Examples, current discussion**
 - Common fiscal policy
 - Banking Union
 - Euro Bonds
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Is a re-design of the EU needed?

- ☐ **World wide economic crisis → (economic) crisis of EU**
- ☐ **The EURO as a problem (?)**
 - No more exchange rate devaluation for weak economies
 - No more monetary policy for specific countries needs („one-size-fits-all”)
 - ☐ (Too) low real interest rates fuel asset bubbles (real estate)
 - ☐ (Too) high real interest rates suppress growth
 - ☐ No „lender of last resort” available
 - ☐ No bail-out of governments / countries
- ☐ **Economic Union - unfinished?**
 - No common fiscal policy
 - ☐ Tax competition
 - ☐ No transfers from strong to weak countries (increasing disparities)
 - Regulation and supervision of financial markets ...
 - ☐ highly fragmented
 - ☐ Race-to-the-bottom
 - ☐ Small states – big banks

Power and assignment of tasks: local-national-EU

How to distribute decision-making power between levels in the EU?



Concepts for cooperation of nation states in the EU

- ❑ **Sovereignty**
 - Take decisions on national level without external restraint
- ❑ **Intergovernmentalism**
 - Inter-national co-operation under control of nation state (Treaties)
 - ❑ The power to pull out stays with states („UK might leave EU“)
- ❑ **Supranationalism**
 - Inter-state relations beyond national control
 - ❑ Permanent loss of sovereignty to a supranational body (ECB, ...)
- ❑ **Multi-level governance**
 - Mixed control: jointly (local), national, EU
 - Stakeholders from all strands of society involved

5

Central or local Where to allocate tasks and resources?

- ❑ **Which level should decide on what – why?**
 - Pro centralisation (EU)
 - Pro de-centralisation (local, national power)
- ❑ **Criteria**
 - Economic: economies of scale, externalities
 - Political: preferences, responsibility to (local) voters, self-rule
- ❑ **Hidden agenda**
 - Maintain / gain responsibilities
 - ❑ Power, influence
 - ❑ Resources
 - A tendency towards centralisation by central bureaucracy (?)

Concepts for sharing responsibilities (1)

In favour of **central** power (Baldwin/Wyplosz, ch. 3)

- ❑ **Increasing economies of scale („big is more efficient“)**
 - Public goods (non-market) cheaper per head on larger scale
 - ❑ Infrastructure, military, basic research
 - Uniform law (transaction cost)
 - Share unemployment costs
 - More bargaining power internationally (WTO, raw material, ...)
- ❑ **Cross-border spillovers, externalities (+, -)**
 - Definition
 - ❑ Economically relevant impact without a contract or compensation
 - Examples
 - ❑ Environment
 - ❑ Spatial planning (transport networks, ...)
 - ❑ Security, immigration („Arabic revolution“!)
 - ❑ Competition in taxation („race to the bottom“)

7

Concepts for sharing responsibilities (2)

In favour of **local** power (Baldwin/Wyplosz, ch. 3)

- ❑ **Diversity and local informational advantages**
 - Diversity of preferences requires a (local, national) variety of solutions, e.g.
 - ❑ DK: defence
 - ❑ UK: social policy
 - Needs best know „on the spot“
- ❑ **Democracy**
 - Responsibility of locally elected politicians for local issues
 - Central election = „take-it-or-leave-it“ packages
- ❑ **Jurisdictional competition**
 - Voters choice: „voice or exit“
 - ❑ „Exit“ rather on local or regional level
 - East-West migration in Germany
 - However: Is the voter always wise?
 - ❑ Respect for needs from other regions (spillovers)
 - ❑ Cutting state expenditure, pension age, etc. resisted

8

Economic and Monetary Union [EMU]

Responsibility	Aims, action
Monetary policy	
EU: ECB (supranational) Members: -	Fight inflation (No: bail-out, lender of last resort)
Fiscal policy	
EU: Limits to deficit (3%) and debt (60%)	Voters preferences = maintain power, tame business cycles
Members: Tax and spend, political agenda	
Competitiveness	
EU: „EU 2020“ etc. Members: Collective bargaining, structural reform, edu, R&D, business climate, ...	Mix of policies, „climate“

Factual tasks and responsibilities of EU

- ☐ **Assigned by**
 - political bargaining and unanimity voting
 - No rational, criteria based division of power
- ☐ **Has EU competencies where this is appropriate?**
Discuss this along the criteria (pro-, against centralisation)
 - Agricultural policy
 - Cohesion and structural policies
 - EMU
 - ☐ Market regulation
 - ☐ Monetary policy
 - Fiscal policy
 - Foreign and security policy
 - Immigration
 - R&D framework programmes

„More Europe“ as a solution (?)

☐ Examples

- Common fiscal policy (Fiscal Union)
- Banking Union
- Euro Bonds

☐ Could problems be solved? (pro – con)

Common fiscal policy (1)

☐ The problem

- Strong and weak countries have different tax revenue and borrowing opportunities
- Weak countries lack means for
 - ☐ Expansive business cycle policy
 - ☐ Appeasement of social groups / regions

☐ Proposed measure

- Vague, unclear and diverse concepts
- Fiscal transfers or joint budget?
 - ☐ Without / with conditionality
 - ☐ Temporarily (crisis follow-up), permanently („transfer union“)
- Example: Bund-Länder-Finanzausgleich Deutschland

☐ Pros and cons

- More equal distribution of income, social peace
 - Acceptance in (rich) populations missing
 - Budget rights of national parliaments violated
 - Moral hazard (less effort and reform)
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Common fiscal policy (2)

- **Hidden agenda**
 - There are good guys (Merkel) that „buy“ power via fiscal transfers over the wasteful bad guys (Greece, ...) [conditionality]
 - **SUMMARY**
 - Dubious concepts – need clarification
 - Negative experience (German Bund-Länder-Finanzausgleich)
 - Complete change in institutions required (Treaty)
 - Super-state EU („**United States of Europe**“)
 - Public sentiment is still national
 - Introduction of fiscal union might be un-democratic !
„No taxation without representation“
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Banking Union (1)

- **The problem**
 - Banks and governments in a negative spiral
 - Governments rely on banks as buyers of gov't bonds
 - Banks are bailed-out by governments (= tax payer) and over-stress the state (Ireland, ...)
 - Big bank – small country
 - Big banks = wonderful jobs + shift of risk to all others
 - Fragmented supervision → regulatory arbitrage
 - **Proposed measure**
 - Common regulatory framework (Basel III, resolution+“last will”)
 - Joint supervision (ECB ?)
 - Joint fund for rescue and resolution of the industry – to be financed by the industry
 - Joint deposit insurance – existing (German) funds to be included?
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Banking Union (2)

□ Pros and cons

- World wide competition – banks just relocate to Asia / USA
- UK wants to protect its strong financial industry
- Existing risks (real estate bubble) to be excluded – how?
- Moral hazard „Common Pool Problem“ [I create a prob – others share the burden]
- Big new bureaucracy for supervision
- Will ECB lose even more independence by supervising banks?
 - Tight monetary policy kills inflation **AND** banks

□ SUMMARY

- Good idea – answer to existing probs
 - Devil in the details
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Euro Bonds

□ The problem

- Some countries downgraded / cut-off from capital markets
 - High interest on fresh money for roll-over and deficit
 - Temporary illiquid – or even insolvent

□ Proposed measure

- Pooled borrowing = average credit worthiness = average interest rate for all
- Strong and weak countries borrow jointly

□ Pros and cons

- Illiquidity and bankruptcy of states prevented
- Moral hazard (austerity and reforms postponed)
- Joint and several liability = the strong countries end up with the bill
- Borrowing costs increase and rating goes down for strong countries
- Legal aspect: Not within framework of EU-Treaties

□ SUMMARY: no solution, not accepted

„Less Europe“ as solution (?)

- ☐ **Exit EURO**
 - ☐ **Back to more national responsibility**
 - Pay your bill yourself
 - ☐ No more „rescue umbrellas“
 - ☐ No more QE by ECB („lots of cheap money“)
 - ☐ No more bond buying by ECB
 - Increase competitiveness
 - Re-gaining trust in capital markets
 - ☐ Austerity
 - ☐ Reforms
 - ☐ **More competition between European nations for best economic performance instead of equalizing and redistribution**
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