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
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?

The EU’s multi-level system

<table>
<thead>
<tr>
<th>Levels</th>
<th>Local</th>
<th>Regional</th>
<th>National</th>
<th>EU</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not (always) hierarchical</td>
<td>Germany: „federal states“</td>
<td>France: centralised</td>
<td>Spain: autonomous regions</td>
<td></td>
</tr>
</tbody>
</table>

Power struggle
- EU
- Member state
- Regions

http://www.dadanlos-europe.org/int/grundkurs4/eu-struktur_3.htm
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

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")

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
### Economic and Monetary Union [EMU]

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

### 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)**

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**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)
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“

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?
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

Euro Bonds

The problem
- Some countries downgraged / 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 BCB
  - Increase competitiveness
  - Re-gaining trust in capital markets
    - Austerity
    - Reforms
- More competition between European nations for best economic performance instead of equalizing and redistribution