Rescuing the Euro – or Bailing Out Profligates?

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What Has Happened – At First Sight?

- Greece Rescue Package by EU and IMF of 110 billion Euros (135 billion US-$).
- EU and IMF General Rescue Scheme of 750 billion Euros (923 billion US-$).
- ECB buys government bonds of the PIIGS (in particular Spain and Greece).
- Disharmonious calls for EU reforms (SGP...)
- Calls on Germany to increase domestic consumption.
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Outline of the Presentation

- What Is the Problem?
- The Stability and Growth Pact and the No-Bail-Out Clause
- Routes for Reform
- Rescue or Bail-out?
What Is the Problem? 1
What Is the Problem? 2

Gross Public Debt in % of GDP 2009 to 2011

BE DE FI FR GR UK IE IT LU MT NL AT PT SK SI ES CY
2009 2010 2011

Forum of Federations, Ottawa,
June 2010
What Is the Problem? 3

Nominal Interest Rates for 10 Year Government Bonds

Deutschland
Spanien
Griechenland
Irland
Italien
Portugal
Looking at the profligate countries:

- Greece obviously cheated regarding its fiscal position when entering EMU;
- But also in the years after.
- Italy, Belgium and Portugal reduced their debt to GDP ratios: SGP was helpful.
- Spain and Ireland held debt to GDP even below the 60 percent levels.
- But: incentives to increase public or private indebtedness.
What Is the Problem? 5

- Why a Rescue Package/Bail-out?
  - It is all about financial markets.
  - Greece, but particularly Spain have been supposed to cause a second Lehman-type meltdown.
  - Not so much a problem of engagement of other European banks.
  - Greece: CDS concentrated in Greek banks.
  - Spain: Fear of banking crises affecting even Santander and BBVA.
What Is the Problem? 6

- Why a Rescue Package/Bail-out?
  - Possible contagion effects.
  - Rhetoric about a rescue of the Euro and the attention its exchange rate attracted is nothing but rhetoric and fuzz.
  - Exchange rate is (almost) unimportant for the contagion problem.

- What is the role of institutional frameworks at the EU level?
The SGP and the No-Bail-Out Clause 1

- Stability and Growth Pact:
    - Deficit to GDP: 3 percent.
    - Gross Debt to GDP: 60 percent.
    - Compatibility if considerably reduced.

- No-Bail-Out Clause: Art. 125 Lisbon Treaty
  - ECB is not allowed to directly buy govt. bonds (Art. 123 Lisbon Treaty).
The SGP and the No-Bail-Out Clause 2

- Excessive Deficit Procedure:
  - Each member state must provide a fiscal report every year containing medium-term planning targets.
  - Stabilization and convergence programs: Are targets realistic?
  - Early warnings of deviations from the targets and proposals to adjust.
  - If Commission thinks deficit is excessive, it proposes measures on which the Council must decide within 3 months.
The SGP and the No-Bail-Out Clause 3

- Excessive Deficit Procedure:
  - Council states excessive deficit: Proposal of adjustment measures to the member country which must be adopted within 4 months and sets a deadline to correct deficit (usually until the next year).
  - Council thinks that there are no effective measures: Publication of suggestions.
  - One month later: Put into delay.
  - 2 further months: Council should impose sanctions (not automatic).
The SGP and the No-Bail-Out Clause 4

Excessive Deficit Procedure:

- Sanctions: Non-Interest-Bearing Deposit at the Commission of 0.2 % of GDP plus 10 % of GDP of the difference by which the actual deficit (in % of GDP) exceeds the threshold; at most 0.5 % of GDP.
- Deposit turns into a sanction after 2 years if the member state does not reduce deficit.
- Extraordinary situations allow higher deficit
The SGP and the No-Bail-Out Clause 5

- **Excessive Deficit Procedure:**
  - Last step before sanctions was set out:
    - Both countries were not accused of not having adopted sufficient measures and were not put into delay.
    - Majority decision by the Council that was accepted by the ECJ.
  - 2005: Revision of the SGP with more procedures.
Routes for Reform 1

- Voluntary or forced exit of Greece:
  - No incentives (voluntary).
  - No legal basis in the Treaties (forced).
  - Economically non-sense.
    - Because of following turbulences.
    - Because devaluation as possible shock absorber is over-valued: Inflation-devaluation spirals.
  - A logistical nightmare when markets unravel.
Routes for Reform 2

- More power to the European Union:
  - Reluctance of many members countries because they do not want to lose budget autonomy.
  - Breach of constitutional law in Germany: Lisbon Treaty decision by the Constitutional Court.
  - Economically dangerous, because it allows to put pressure on the ECB.
  - Germany has no interest: Lagarde criticism
Routes for Reform 3

- **Strengthening the SGP:**
  - Requirement to introduce national debt brakes German style: Could be a Directive.
  - Requirement for independent statistical offices: Could be a Directive.
  - Further procedural changes: also Directive.

- **Bankruptcy Code (Directive?):**
  - Asymmetry between SGP and No-Bail-Out Clause must be resolved.
  - U.S. Law provides help.
  - Paris and London Clubs are insufficient.
Rescue or Bail-out?

- Rescue and Bail-out!
- No rescue of the Euro.
- But rescue of European banks and prevention of contagion.
- Bail-out as well with all negative incentives.
  - Whether the oversight suffices to induce the necessary fiscal adjustments in Greece is questionable.
- Necessity to have bankruptcy code.