Rescuing the Euro – or Bailing Out Profligates?

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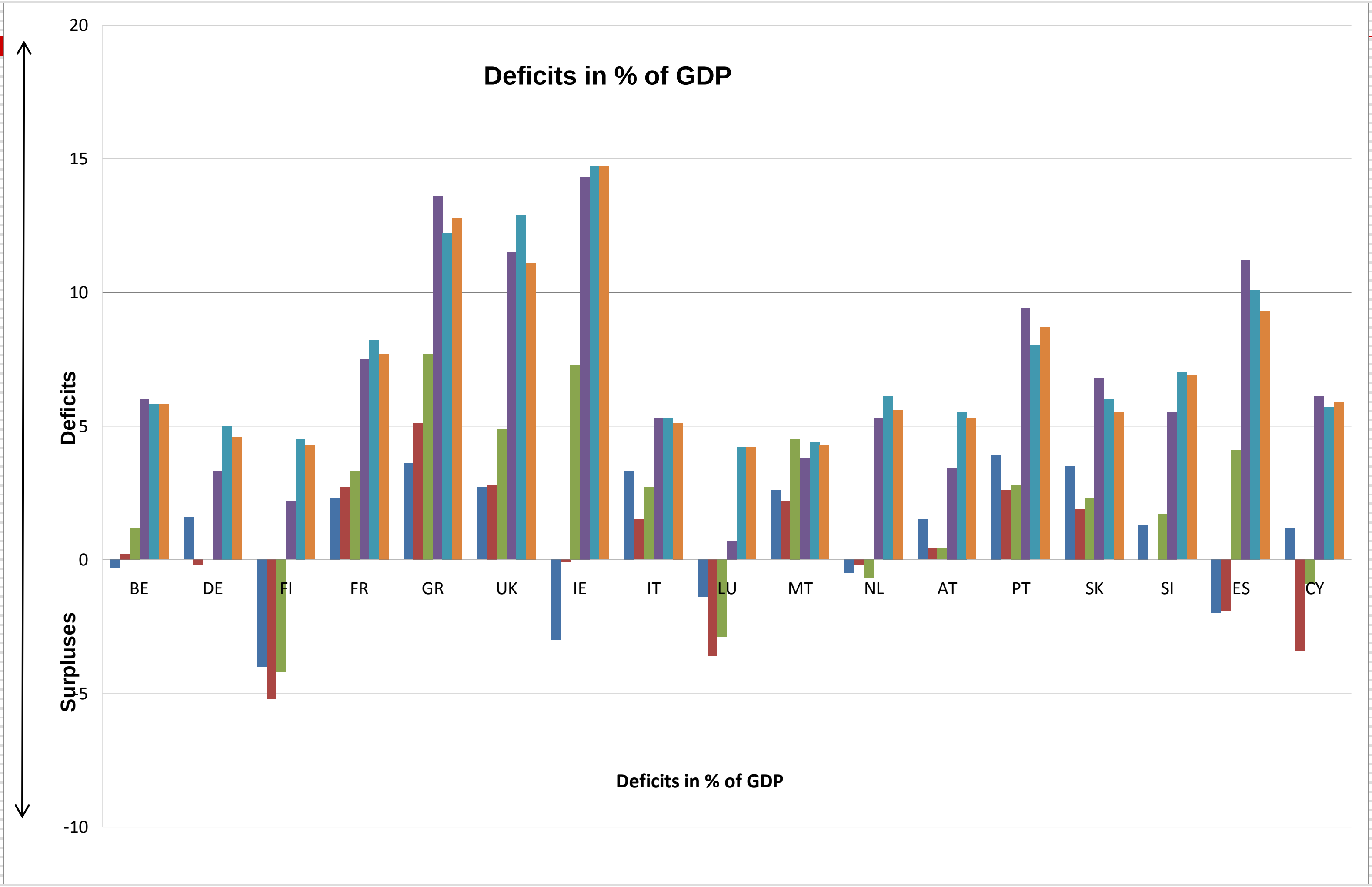
What Has Happened – At First Sight?

- 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.

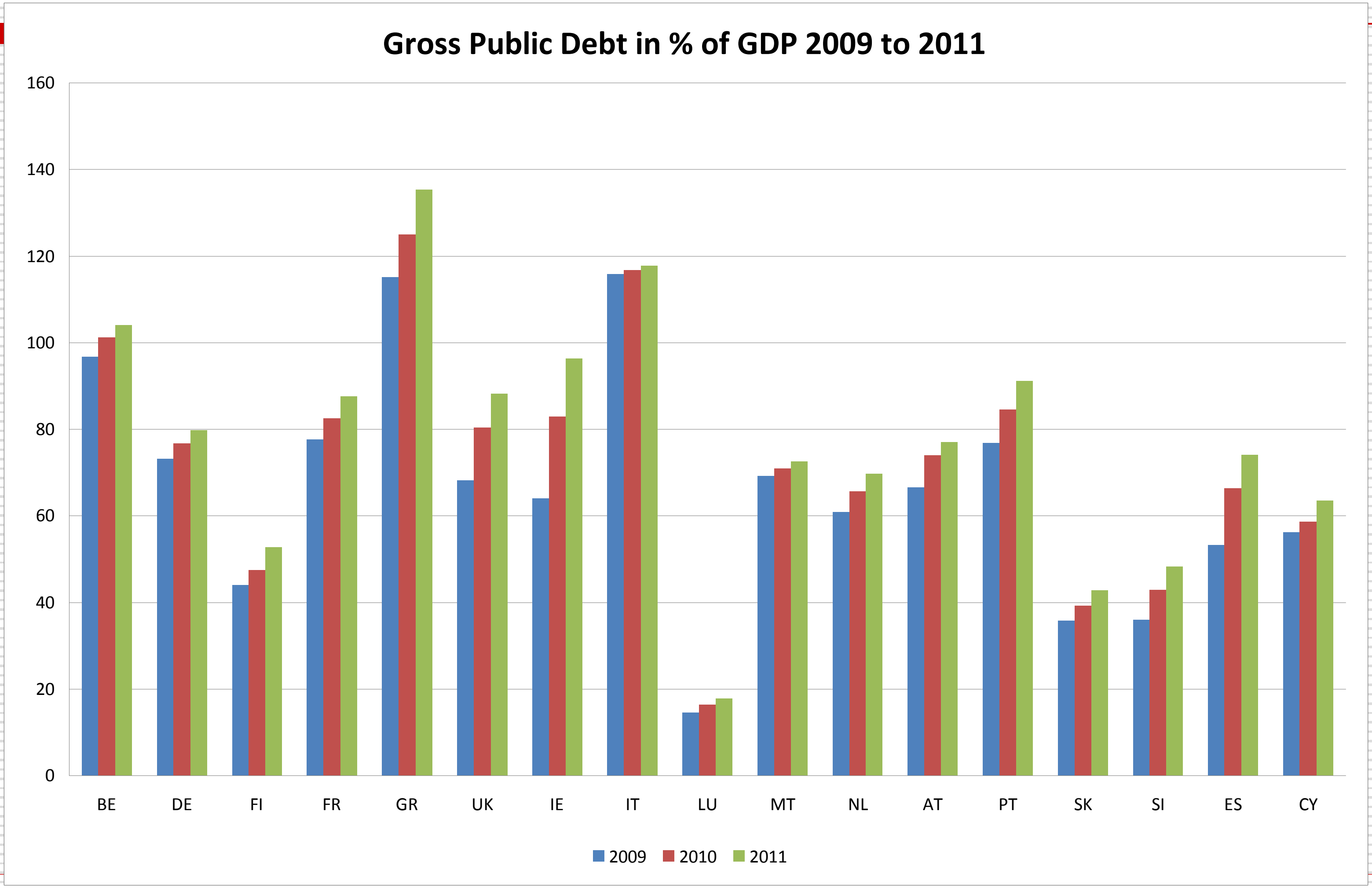
Outline of the Presentation

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

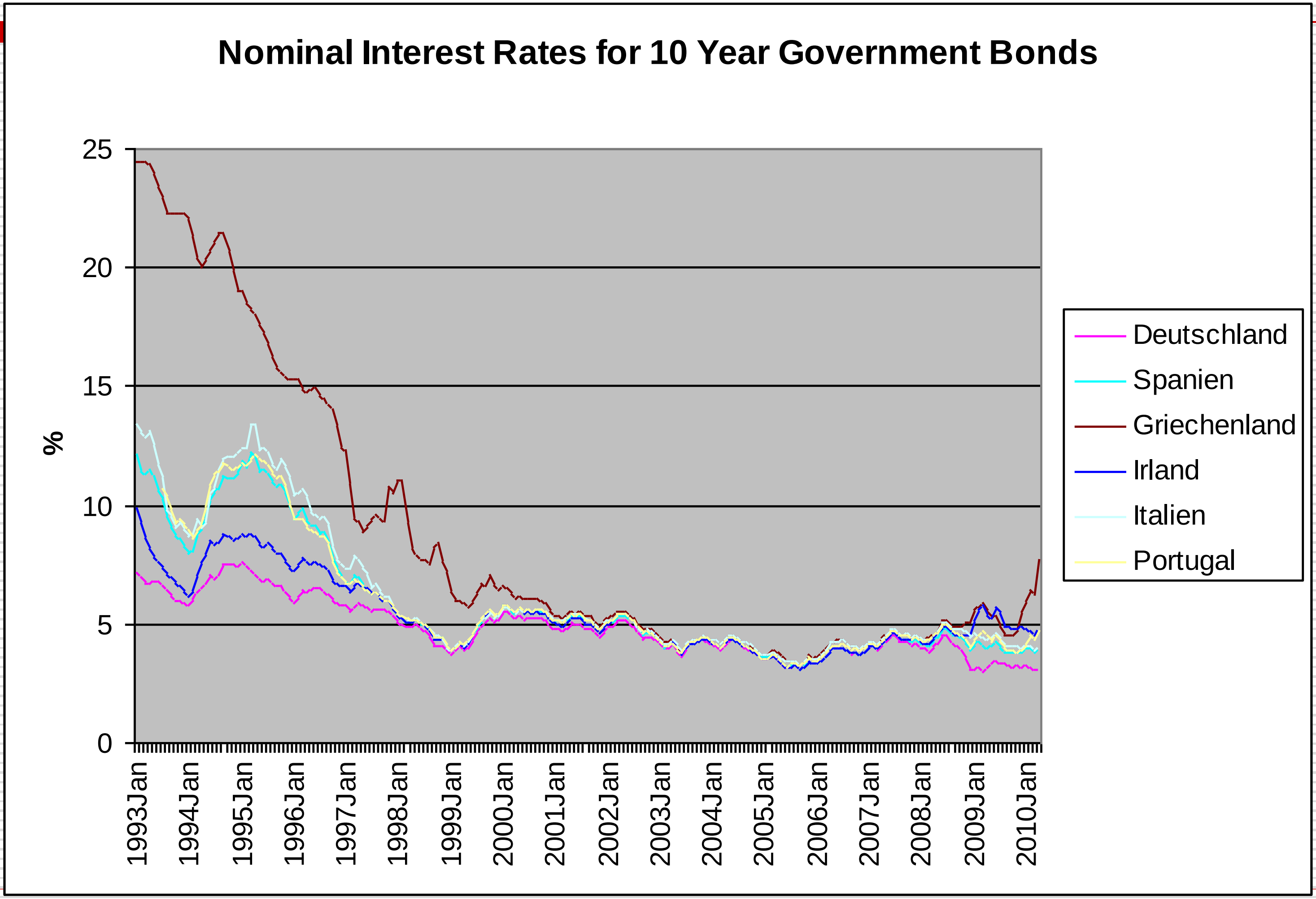
What Is the Problem? 1



What Is the Problem? 2



What Is the Problem? 3



What Is the Problem? 4

- 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:
  - Art. 126 Lisbon Treaty (Art. 104 EC-Treaty) in connection with the Excessive Deficits Protocol.
    - 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:
  - 2002 – 2004: Excessive deficit procedure against France and Germany.
  - Last step before sanctions was set out:
    - Both countries were not accused to 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.