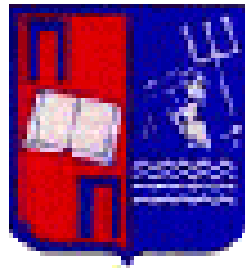


Can the Eurozone Reform?


by

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Economist Conference on: "Governance and regional arteries for Growth: Europe's momentum – Greece's impetus,"
Wyndham Loutraki Poseidon Resort, Greece, **May 10-11, 2018**

The Greek crisis exposed the faults in the Eurozone, revealing the need for reform

- ❑ During the **international crisis 2007-2009** many financial rescue decisions were taken within the **G-20** forum  the crisis did not raise concern about the stability of the Euro Area
- ❑ It was the **Greek crisis** which raised awareness of the EA faults as it caught Euro Area unprepared
 - The **OCA** discussion and the final goal of the **Political Union** resurfaced
 - Europeans rushed to rescue Greece in May 2010, abandoning the **no bail-out principle**; created the EFSF
 - Yet at Deauville in October 2010 they wavered back, afraid of **moral hazard** and fiscally irresponsible copy-cat countries, hence claiming bail-ins, not bail-outs, would be the rule of the future
- ❑ **ESM** was created
- ❑ **Banking Union** decision

Banking Union in Europe

- ❑ SSM since November 2014, looks over ≈128 large banks
- ❑ SRM since 1/1/2016

Banking Union

Art. 127(6) TFEU: "The Council, ..., may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions ..."



Daniele
Nouy

Single Supervisory Mechanism (SSM)

ECB as central prudential supervisor of credit institutions in the Euro area

- Separation of prudential supervision from monetary policy
- Based on SSM Regulation and on SSM Framework Regulation
- In effect since 4 November 2014



Elke König

Single Resolution Mechanism (SRM)

Single Resolution Board (SRB) as central European resolution authority for the Banking Union

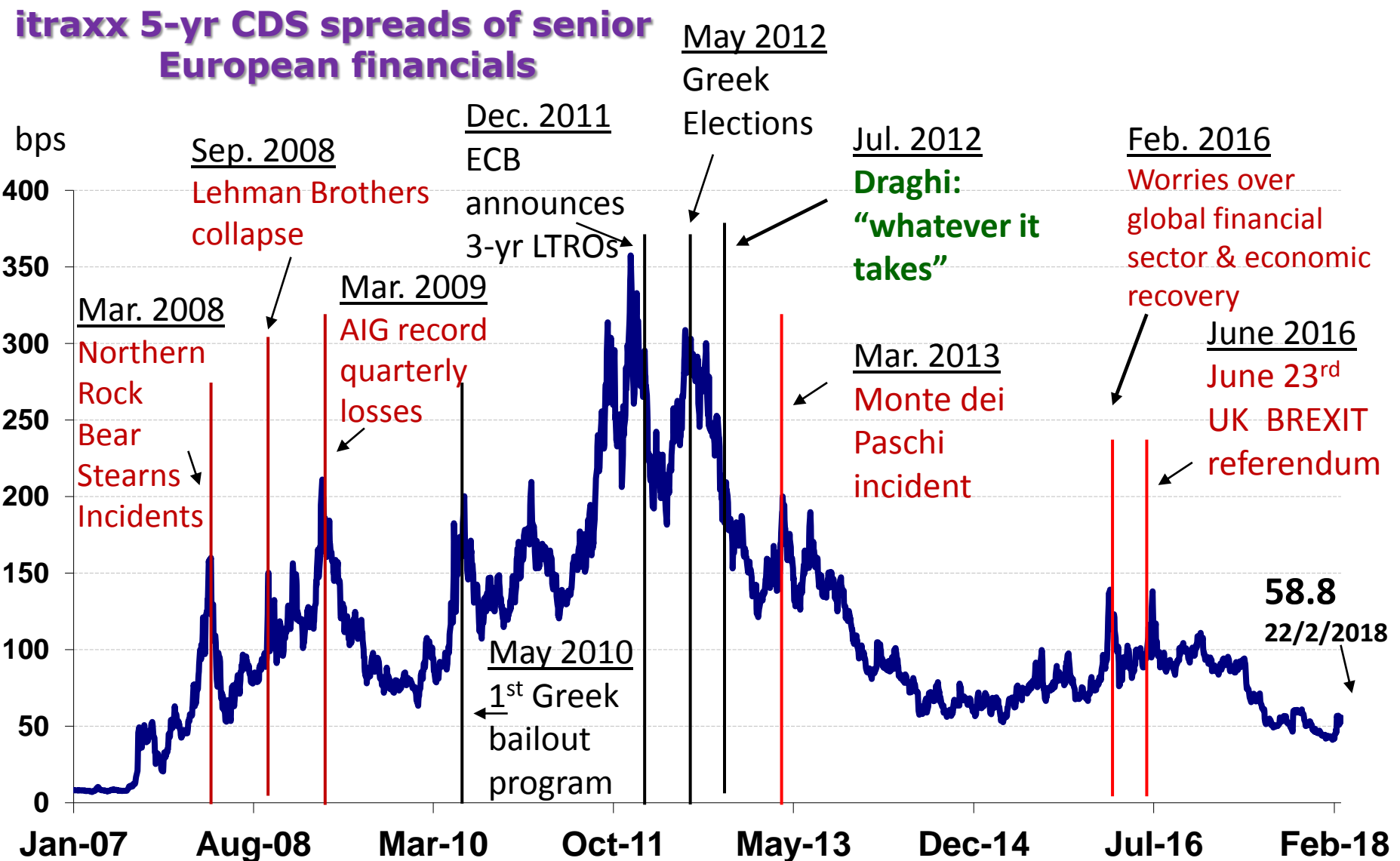
- Single Resolution Fund replacing national resolution funds
- Based on SRM Regulation
- Applies to credit institutions covered by SSM from 1 January 2016

European Deposit Insurance Scheme

- Proposal by EU Commission to be published before the end of 2015
- Handling of larger shocks and increasing depositor confidence
- Level playing field for all credit institutions under Banking Union
- Based on "reinsurance approach"

Single Rulebook: CRD IV/CRR, BRRD, DGSD

Bank CDS spreads as the fear index: Higher during the Greek & Eurozone crises and still high



Euro Area reform has stalled: Why?

- ❑ As the economy rebounded, reform pressure subsided:
 - Not much is done since the Single Resolution Mechanism of July 2014, which is part of the Banking Union, and was initiated in the midst of the crisis in 2012
- ❑ Two sides to the debate (**crisis mitigation vs. prevention**):
 - (A) France, Italy and the European South worry about **crisis mitigation**; they support additional mechanisms of risk-sharing and stabilization, stronger governance
 - (B) Germany, Netherlands, and others worry about moral hazard and **crisis prevention**; they oppose additional risk sharing, and instead propose tougher enforcement of fiscal rules , market discipline

Euro Area reform: Yes it can be done

- ❑ The IMF came out in Feb 2018 with a proposal for a tighter fiscal union
- ❑ In Jan 2018 , a dozen French & German CEPR economists offer ideas on a number of financial, fiscal and institutional reforms that would improve both crisis prevention and crisis mitigation, i.e. both market discipline (→ lower moral hazard) and risk sharing (→ mitigate a crisis) in the Euro Area:
 - 1) Break the Bank-Sovereign doom loop via sovereign bond concentration charges for banks and a common deposit insurance
 - 2) Switch to fiscal targets based on simple expenditure rules & finance possible planned deviations from those targets with junior debt
 - 3) Make the “no-bailout” clause time-consistent by designing orderly debt restructurings through legal and economic means
 - 4) Create a Euro Area fund to absorb large economic disruptions, with contributions proportional to its possible use
 - 5) Create a synthetic Euro Area safe asset (like a CDO)
 - 6) Reform the Euro Area institutional architecture by separating the watchdogs from the political decision makers

Euro Area is expected to reform and last; Will Greece tag along?

- ☐ **Reform** is the key word for economies to grow; it is also the key word for the Eurozone to survive
- ☐ Will **Greece** continue as a **Eurozone member** 10 years ahead?
 - Only if Greece reforms and remains fiscally prudent
 - European “enhanced” supervision
 - Has Greece learned from the self-induced crisis Phase II of crazy 2015?

