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The Future of EU Economic Governance: Lessons from European Crisis

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1. How EU confronts the financial markets

2008–2011

- ▶ Financial Crisis → Economic Crisis → Fiscal Crisis

This pattern is typical one !

1999–2006 (South European Countries)

- ▶ Lower interest rate → Asset Price Bubble Emerging + High growth of Consumption → Bubble burst (triggered by subprime crisis in U.S. ?) → Financial Crisis

- ▶ Prof. Rawlinson pointed out Revision of Pact during 2003–05. This was wrong sign!
- ▶ Furthermore, in 1990s and 2000s, most of economists believed equilibrium mechanism of the markets. Low inflation, globalism , flexible labor market etc emerged.
Not only EU but U.S. were not cautious for recession or crisis.

Grounds for Concerns; 2011 –

1. Fiscal Crisis → Financial Crisis → Econ Crisis
Reverse pattern of crisis

If a disorder default breaks out, most banks will face massive loss in their balance-sheets. Then, “credit crunch and higher interest rates” will be brought.

They will trigger economic crisis in EU area.

2.Look back on the EURO Introduction

- 1) Incomplete convergence criteria ?
- 2) Greece participation in EURO area all-right ?
- 3) Delayed reforms of economic systems
- 4) Monetary integration without fiscal integration

1) Incomplete convergence criteria ?

- ▶ Convergence criteria in Maastricht Treaty focused mainly on the demand sides of members' economies.
- ▶ Supply-side, or international competitiveness in Euro Area was neglected on purpose.
 - ← Convergence of the competitiveness is so difficult and time-consuming process.

For example, current account ratio per GDP would have been introduced.

2) Greece participation in EURO area all-right ?

- ▶ In 1990s, convergence criteria was required for participation of the EURO.
- ▶ Greece was imperfect achievement in fiscal criteria. But we learnt that later.
- ▶ This indicates Greek government has been difficult to control her budget.
- ▶ When we think Greek participation now, it was inadequate ?

3) Delayed reforms of the economic systems

- ▶ Changes of supply sides have delayed, because most are unwilling to accept change of life(?).
- ▶ Changes mean more flexibility of labor markets, more mobility of product factors, more transparency of transaction and business customs.
- ▶ Those delays affect less competitiveness.

4) Monetary integration without fiscal integration

- ▶ Fiscal policy is restrained by the rule, “Structural and Growth Pact”.
- ▶ But, there is no “coordination rule” for fiscal deficit, expenditure, transfer between central governments.
- ▶ Lisbon Treaty prohibits Fiscal support to other member countries as a rule.
- ▶ “Rule must be revised in case of necessity !”

Current Crisis reveals need of fiscal coordination or support

▶ Why?

1. Central bank function as LLR(Lender of Last Resort) requires fiscal support to ECB.
2. Fiscal crisis of member countries will result in emergent support by other countries.→This is a controversial point.

- ▶ Fiscal supports may bring about “moral-hazard” of crisis countries.
- ▶ However, economic linkage in Euro Area is more strengthened.
- ▶ So, fiscal support dared to be introduced.
- ▶ Next section, we will propose reform of EU economic governance.
- ▶ Also, we will propose temporal resolution for Greek crisis.

3.Reforms of EU Economic Governance

- ▶ 1.EU Fiscal Integration
- ▶ Fiscal supports in EU are unpopular political options.
- ▶ However, partial collapse of Euro–Area must be avoided, because benefits of the maintenance are larger than the costs.

- ▶ Benefits: larger exports to intra–Euro Area.
Efficient financial market
evolution of new business etc.
- ▶ Costs: Structural reforms of economic systems
Short–term supports to fiscal crisis members

- ▶ If (future) reforms of EU economic governance will be secured, agreement of fiscal assistance to Greece may be achieved.
- ▶ Greece should accept a declaration of default.
- ▶ But, this is short-term resolution, not structural one.

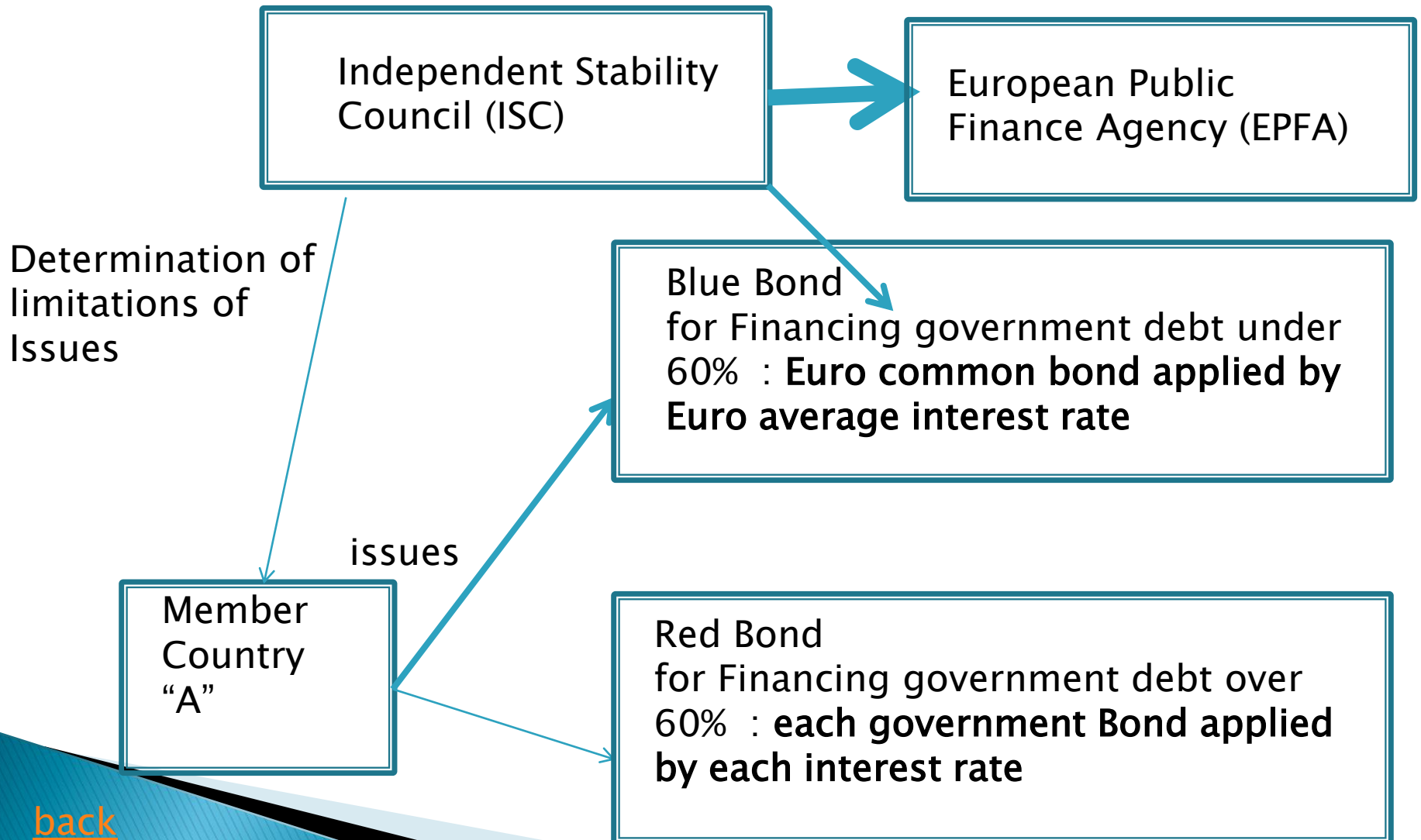
What future Economic Governance in EU ?

- ▶ Main point of our proposal
 1. Strengthening of monitoring fiscal stances of member countries
 2. Approval of default of member government
 3. Introduction of Emergent assistance among member countries
 4. Strengthening economic reform of a default member

▶ My definite proposal

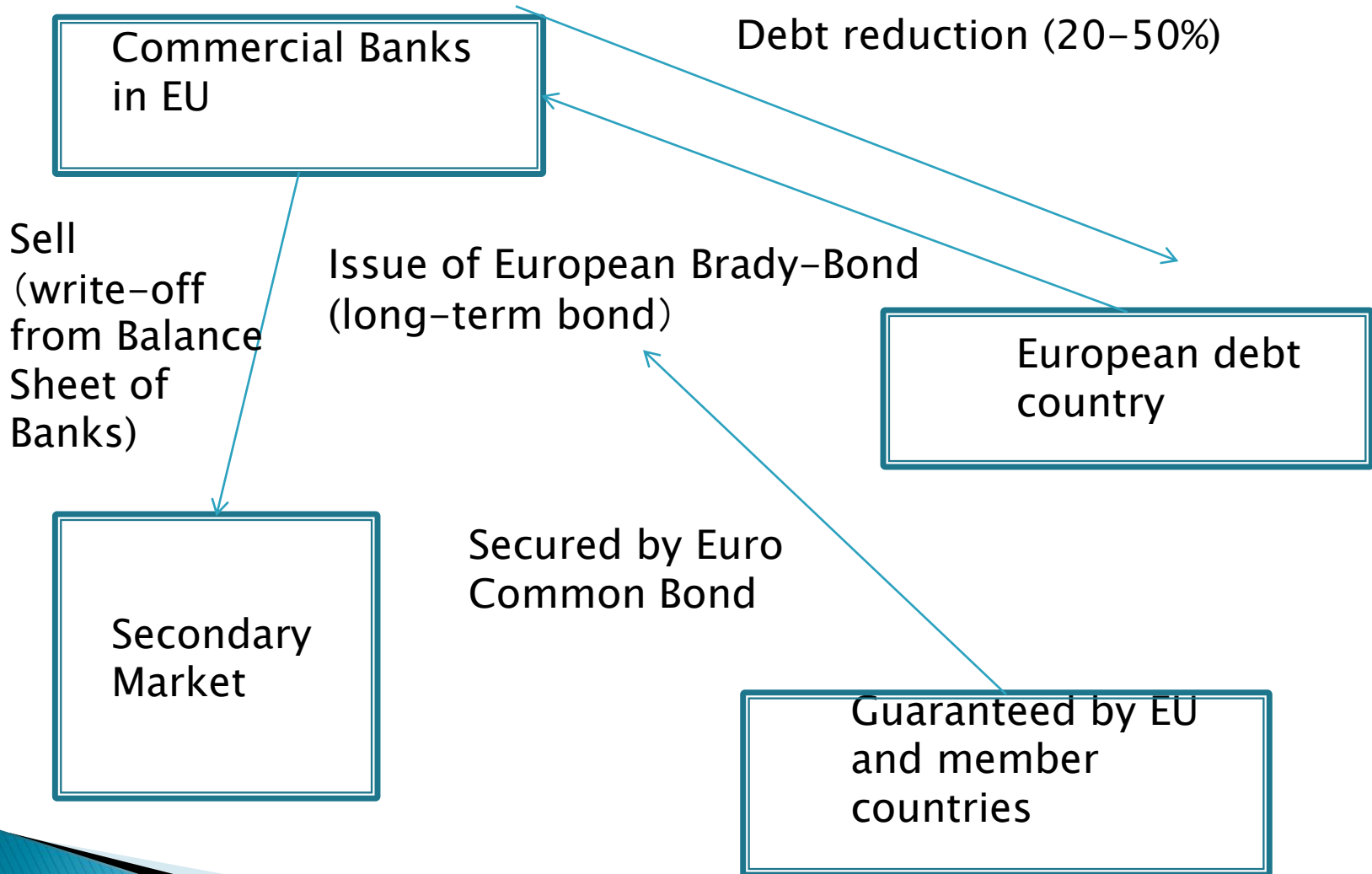
1. Approval of Euro Common Government Bond
→ Blue Bond proposal by BRUGEL [slide A](#)
2. Introduction of European Brady Bond for the default scheme [slide B](#)
3. Expansion of European Monetary Fund (EMF) from EFSF, with European Public Finance Agency (EPFA) [slide C](#)
4. Creation of EU Emergent (standby) Fund in EMF [slide D](#) [Next section](#)

A. Euro Common Bond Proposal(by Brugel)

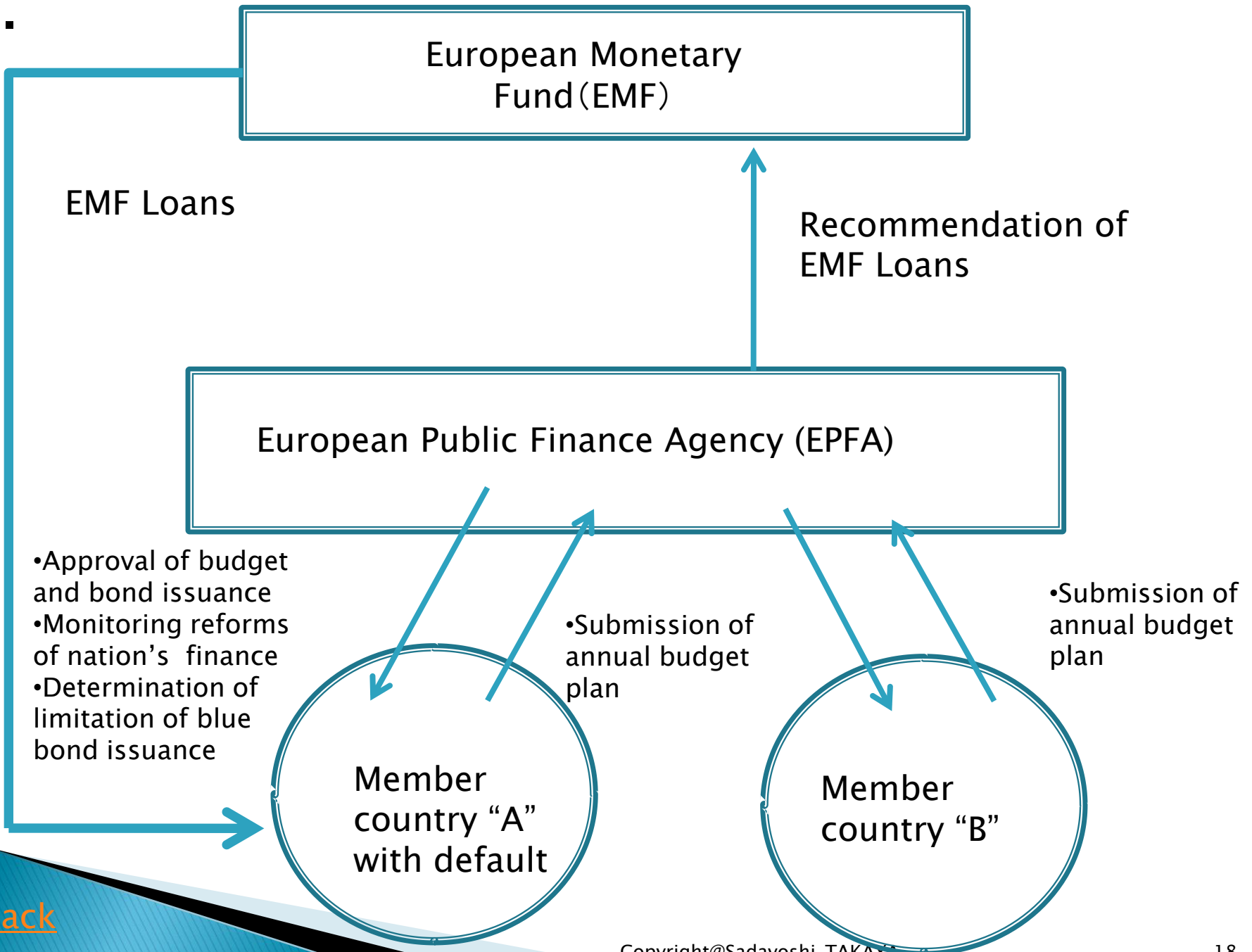


B. European Brady-Bond Scheme

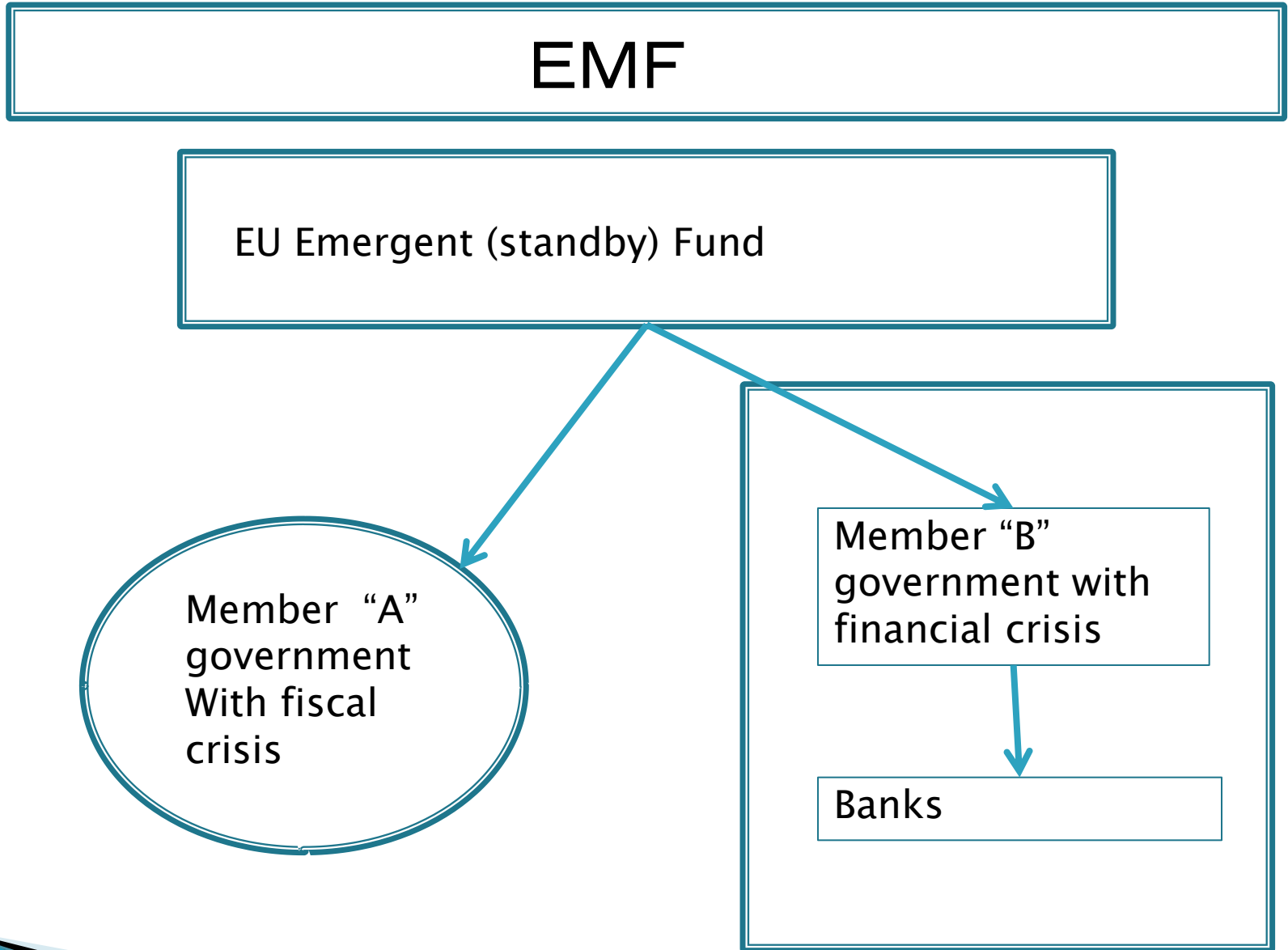
write-off of claims
→ loss



C.



D.



4. Unsolved issue ?

- ▶ How should Current Account disequilibrium be dealt with ?
 - New criteria will be introduced, for example, Current account ration per GDP ?
- ▶ Structure reforms will continue in fiscal crisis countries? Innovation and new industry will emerge in all member countries ?

Mr. Bexs points out that Europe 2020 will be important strategy. I also expect, but..... ?