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Innovations in solving Eurozone crisis – review of some unconventional proposals

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Eurozone crisis

- Causes:
  - market failure/state failure/EMU design
- Consequences:
  - unemployment, bankruptcies, debt instability, deleveraging, etc....
- Adopted solutions:
  - Six Pack & Two Packs, MIP, Banking Union, etc..

Review

BEB - Basket Eurobonds Peter Bofinger 2014	Breathing Eurozone - EMU of variable size H.W. Sinn 2013	European Investment Guarantee Scheme (EIGS) F. Zuleeg 2013
European Redemption Pact Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung 2011	Rearrangement of the ECB System M. Burda 2013	Fiscal Interest Rate Equalization (FIRE) ZEW 2012
PADRE: Politically Acceptable Debt Restructuring in the Eurozone Pâris & Wyplosz 2014	A Copernican turn in Banking Union T. Mayer 2013	Debt-for-equity swaps P. Allen, B. Eichengreen, G.Evans, 2014

Framework

Conceptualization of crisis challenges – framework for analysis of unconventional options

Fiscal Stability	Financial Sustanability	Economic Growth
• public debt • interest rate • deficit	• banks' risk taking • safe deposits • financial disintegration	• new firms • more employment

Option I

- **Basket of Eurobonds (BEB)**
- Peter Bofinger, 2014
- New instrument, issued and traded as a single debt instrument

Fiscal stability	lower interest rate thanks to the fluid BEB market	**X**
	lower deficit as a result of more favourable conditions for debt repayment (lower yields)	**X**
Financial sustainability	financial disintegration lessened thanks to fluid BEB market preventing sudden shifts of investors from one market to another	**X**

Option II

- **European Redemption Fund and Pact**
- Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung 2011
- partial, temporary mutualization, strictly conditional and secured joint liability

Fiscal stability	debt reduction via its repayment with the help of other members states	**X**
	lower interest rate (bond yields) due to joint liability	**X**
	lower deficit thanks to the "debt brake" provision and lower refinancing costs	**X**
Financial sustainability	financial disintegration on the mend due to restored confidence (unfreezing markets)	**X**

Option III

- **PADRE - Politically Acceptable Debt Restructuring in the Eurozone**
- P. Pâris and Ch. Wyplosz, 2014
- Inter-temporal, within nation shifting of debt burden, bonds backed by stream of seigniorage

Fiscal stability	debt overhang solved via a swap "securitization of ECB seigniorage for debt"	X
	lower interest rate due to calmer markets	X
	likely lower deficit level thanks to the obligation to comply with TSCG and implementation of "debt brake"	X
Financial sustainability	financial disintegration alleviated thanks to reduced risk of default implying lower possibility of investors run	X

Option IV

- **Rearrangement of the ECB System**
- M. Burda, 2013
- Depoliticising and denationalising; reshuffling current order of central banks system

Fiscal stability	deficit level reduced indirectly via stricter rules for refinancing credits in ECB – creditworthiness of sovereign bonds as collateral	**X**
Financial sustainability	bank risk-taking reduced due to bail-in and “haircut” rules	**X**
	financial disintegration mitigated via redesign of the whole EMU and removal of national/political aspects of common monetary policy	**X**

Option V

- **Breathing Eurozone - EMU of variable size**
- H.W. Sinn, 2013
- new order/ mechanism with ex ante exit possibility (upgrade of the whole EMU)

Fiscal stability	partial debt slash via PSI and OSI	**X**
	„deficit brake" provisions	**X**
Financial sustainability	banks risk taking lower due to regulations aiming at internalising externalities	**X**
	financial disintegration disabled due to obligations to settle balance of payment imbalances	**X**

Option VI

- **Copernican turn in Banking Union**
- T. Mayer, 2013
- bottom up constructing of resilient banking union

Fiscal stability	deficit level stabilised thanks to the regulations governing banks' exposure to governments' bonds	**X**
Financial sustainability	bank risk-taking lowered due to hierarchy of loss absorption (bail-in)	**X**
	possibility of run on banks leading to liquidity/insolvency problems reduced thanks to requirement of fully backed safe deposit with central bank reserves	**X**

Option VII

- **Fiscal Interest Rate Equalization (FIRE)**
- ZEW, 2012
- solidarity subventions for servicing debt

Fiscal stability	Interest rate in crisis countries lowered thanks to the "subsidy" mechanism (FIRE)	**X**
	deficit level lower in result of debt stabilisation and reduced interest rate	**X**
Financial sustainability	financial disintegration affected due to clear rules, partial equalization of interest rate enabling restoring confidence on markets	**X**

Option VIII

- **European Investment Guarantee Scheme (EIGS)**
- F. Zuleeg, 2013
- Joint guarantees & insurance stimulating investment and growth

Financial sustainability	financial disintegration reduced due to the incentives to better allocate capital across borders	**X**
Growth	new firms thanks to the available funding and lower risk	**X**
	more employment due to more investments and better business conditions	**X**

Option IX

- **Debt for Equity Swap**
- P. Allen, B. Eichengreen, G.Evans, 2014
- Trading off expensive form of financing with participatory one

Fiscal stability	possible partial debt slash thanks to debt for equity swap	**X**
Growth	new firms due to inflow of capital directed do productive investments (debt exchanged for equity)	**X**
	more employment likely due to investments	**X**

Concluding remarks

- Surveyed proposals are *inventions*, ideas, concepts

- They are *innovations* (outside mainstream of economic thinking and political action; *unconventional* i.e. in opposition to or modyfying the EU proposals, compliance with EU official solutions vary) but can lead to *prosperity* (via 1,2,3)

- Their *novelty* i.e. non-tested character at least in the EU can come in many forms:
  - new mechanism – ERP, PADRE, debt-equity swap
  - new sequence – Banking Union „upside down"
  - new rearrangement – ECBS new line-up
  - new regime – breathing EZ
  - new institutions – EIGS
  - new instruments – BEB, FIRE

Concluding remarks

- Seeking to strike the balance between dwelling too much on certain proposals and simply listing all ever submitted alternatives
- Risk of stretching the interpretation too far - what can be logically presumed and derived from design and what authors claim themselves
- Heterogeneous group tough to be assessed by uniform criteria
- Worth considering as first aid kit for future crisis

Concluding remarks

- Main value added:
  - compiling dispersed alternative proposals,
  - outlining their main premises,
  - undertaking attempt to evaluate them in a coherent way.

- Options….
  I. target deficit mainly,
  II. focus on financial fragmentation,
  III. impossible to disentangle and pinpoint the „growth” channel.

Concluding remarks

- Preference reflects the fact that fiscal area is easier to be managed and instability to contain than financial domain - banking sector (sovereigns can be disciplined, peer pressure, criteria, etc. banks - lobby one step ahead) whereas both contribute to economic growth in the end so it doesn't need to be addressed specifically

- Limitations : authors bias, framework for assessment imprecise (more robust approach specify debt as overhang, deficit as primary only), new alternatives, short run adverse effects – i.e. increased volatility…

Thank you for your attention

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