Reforms and Governance in EMU

Guido Tabellini
(Bocconi University)
Outline

1. Incentives for national reforms

2. What can be done at EZ level?

3. Concluding remarks
Incentives for national reforms

*Before the crisis:*
- Economic integration and convergence did NOT lead to institutional convergence
  Alesina, Trebbi and Tabellini, *BPEA* 2017

*Since the crisis:* Some reforms, but....
- Populist threat as an additional political constraint
  - Further economic hardship may be counter-productive

Need reforms to deeper political institutions?
  Majoritarian political systems (cf. France)
Mkt discipline vs external institutional constraints

• Mkt discipline too late and too sudden

• Legacy debts too high

• “Doom loop” hard to avoid, even if banks held a diversified portfolio
  – Redenomination risk; recession; capital flight

• External institutional constraints do matter
A European SDRM?

- Purpose: to facilitate restructuring?
  - D is issued under national law
  - CAC reduced the cost of borrowing!
  - Ex-Post, an international court would protect creditors, not debtors

- Automatic bail-ins as pre-condition for ESM assistance?
  - Not clear how to achieve this (why should creditors agree?)
  - Legacy debt and risk of confidence crisis
  - Liquidity vs insolvency
  - Decision to restructure of enormous importance
A Seniority Structure on Public Debt?

• Need external enforcement or intnl coordination

• New debt should be junior, particularly if in excess of pre-established path
  More expensive at the margin

• Analogy with SIFI: issue equity-like instruments to achieve D reduction during crisis
GDP linked bonds

Implicit juniority through indexation to nominal GDP

Stabilizing during crisis

Objections:

- Statistics are manipulable ex-post? But...Eurostat
- Liquidity premium too high? But.... Intnl agreements to issue it on a large enough scale
- Contingencies too expensive? Unclear

Intnl agreement to issue it in some minimum amount. Force high D countries to issue more, if D is not coming down fast enough?
A minimalist reform agenda for EZ

• What about more ambitious EZ reforms?
  Common budget for EZ

• Economic divergence and conflict of interest inside the EZ just too large
  Reduction of legacy debt as pre-condition for more ambitious EZ reforms

• Ambitious reforms to be pursued in other areas
  Common defense and security policy, foreign policy, border control and immigration
Summary

• Main priority: reduce risk of another financial crisis

• Strengthen external constraints on fiscal policy to achieve fast reduction of legacy debts

• Avoid EZ reforms that create global instability
  European SDRM; Automatic Bail-ins; Forced diversification of bank portfolios

• Coordinate on issuing GDP linked bonds

• Ambitious reforms in areas other than EZ