

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 intl 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.... Intl agreements to issue it on a large enough scale
- Contingencies too expensive ? Unclear

Intl 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