

USC Global Leadership Summit

Government Financial Accountability & the European Economic Crisis: Paths to Prosperity

- Multi-disciplinary → cross-fertilization of professional insights.
- Transparency and accountability → Governments build trust and confidence.

Some remarks on

- Usefulness of independent councils: An example.
- Improving market discipline in EMU: A proposal – Maastricht 2.0.



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LAYING *the* FOUNDATION *for* RECOVERY & GROWTH

The state of the economy calls for action, bold and swift, and we will act — not only to create new jobs, but to lay foundation for growth.

— President Barack Obama



Germany 1963: Federal law about the creation of a Council of Economic Experts, Federal Minister of Economic Affairs, Ludwig Erhard.



Chancellor Konrad Adenauer: „Erhard, woll'n Se sich 'ne *Laus* in'n *Pelz* setzen?“

Idiom, like ..

„Erhard, do you
want to put a burr
under your
saddle?““?”





2013: Against a backward-looking economic policy

2014: More confidence in market processes

2015: Focus on future viability

ZUKUNFTSFÄHIGKEIT
IN DEN MITTELPUNKT

Jahresgutachten

15

German Council of Economic Experts

5 academics, 5-year rolling appointments,
independent.

- assess current and future economic development
- aid public & institutions in making informed judgements
- examine how to ensure steady growth in market economy, while maintaining high employment, price stability and foreign trade equilibrium
- point out undesirable developments, discuss how to avoid them, without advocating specific measures

Annual cycle

Summer & fall: Hearings with institutions, ministers, government officials, employers and trade unions.

November: Handover of GCEE Annual Report to Chancellor & public press conference

January: Reply in Government Annual Economic Report prepared by Ministry of Economic Affairs.

Spring: Publication of updated GCEE economic forecast & lunch meeting with Chancellor and Ministers.

Throughout the year

Monthly meetings, press articles, speeches.

Occasionally a Special Report.

*July 2015, Consequences of the
Greek Crisis for a More Stable
Euro Area*

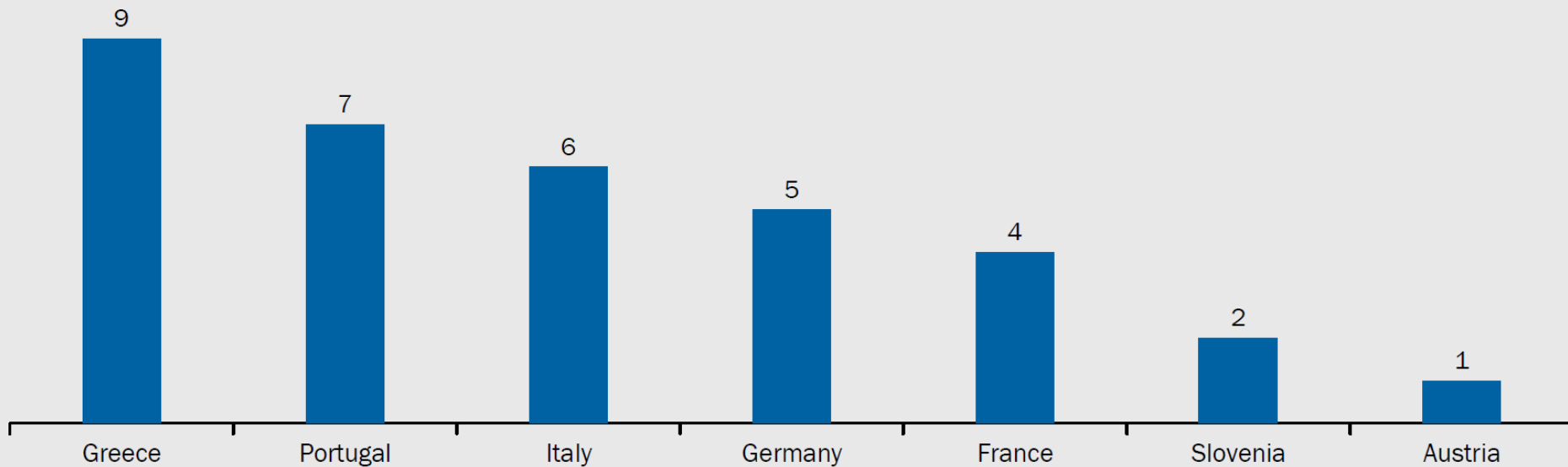
A currency union of sovereign states.

- *Advantage:* more deeply integrated goods and financial markets, lower transaction costs.
- *Disadvantage:* Monetary policy and nominal exchange rate not available as instruments for macroeconomic adjustment in member states.
- *Alternative adjustment mechanisms:* internal devaluation via wages and prices. Labor mobility. Fiscal policy and other economic policies.

Failure of Maastricht and solutions

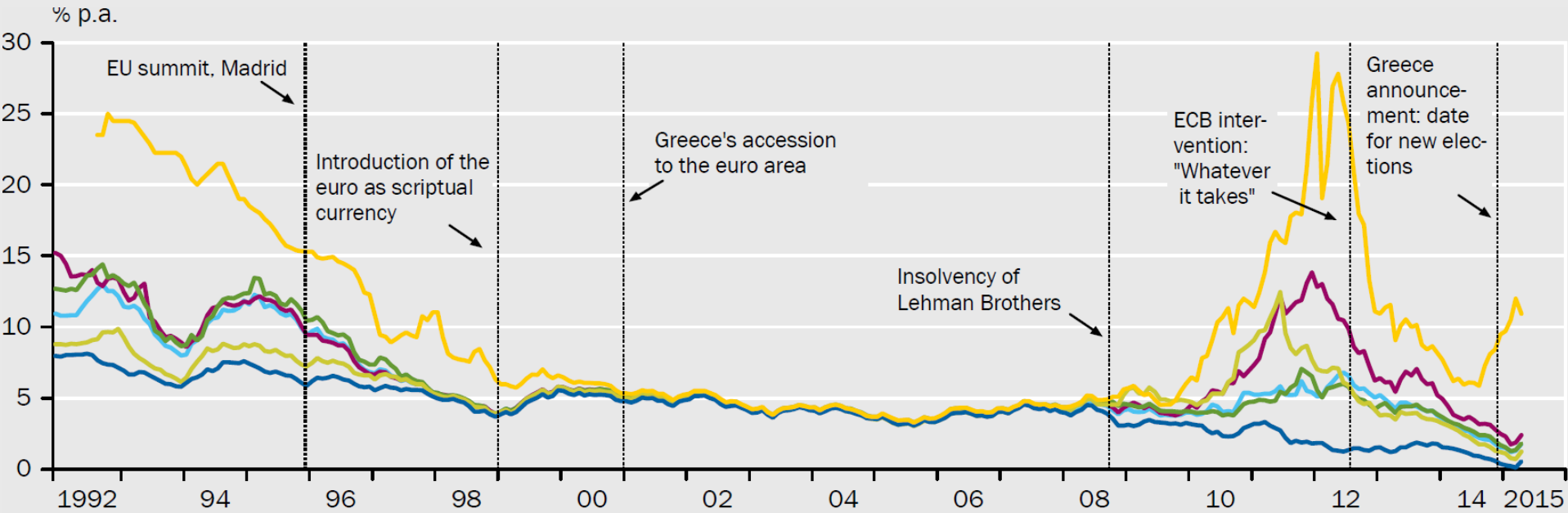
- Liability and control need to be unified.
- Yet, mis-aligned incentives and moral hazard contributed to surge in private and public debt to unsustainable levels.
- **Solution A:** Political Union. Sovereignty regarding finances and budget is transferred to supra-national level.
- **Solution B:** Budget control and liability on national level, market discipline, strengthen no-bailout, reform Maastricht.

Example of failure: Fiscal rules not followed, sanctions not applied consistently.



Breaches of 3% deficit rule: 1999 - 2007

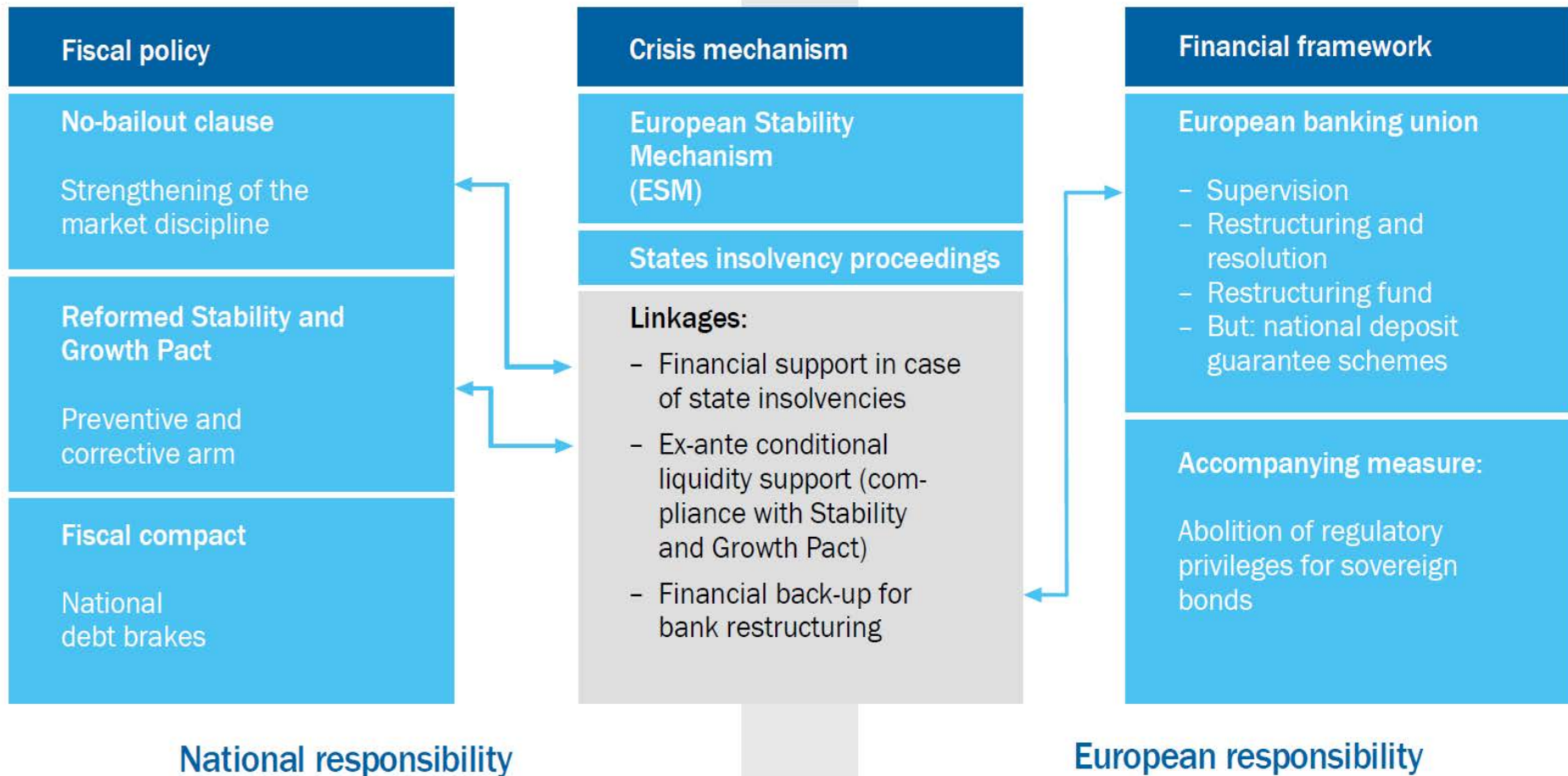
2nd example: Different sovereign debt treated the same in financial markets and regulation.



Long-term government bond yields

Germany Greece Ireland Italy Portugal Spain

A solid framework for the euro: Maastricht 2.0



Sovereign insolvency regime

- Orderly regime in context of ESM program application
- Analysis of debt sustainability
- If not sustainable debt extensions
- And if still not sustainable debt cuts

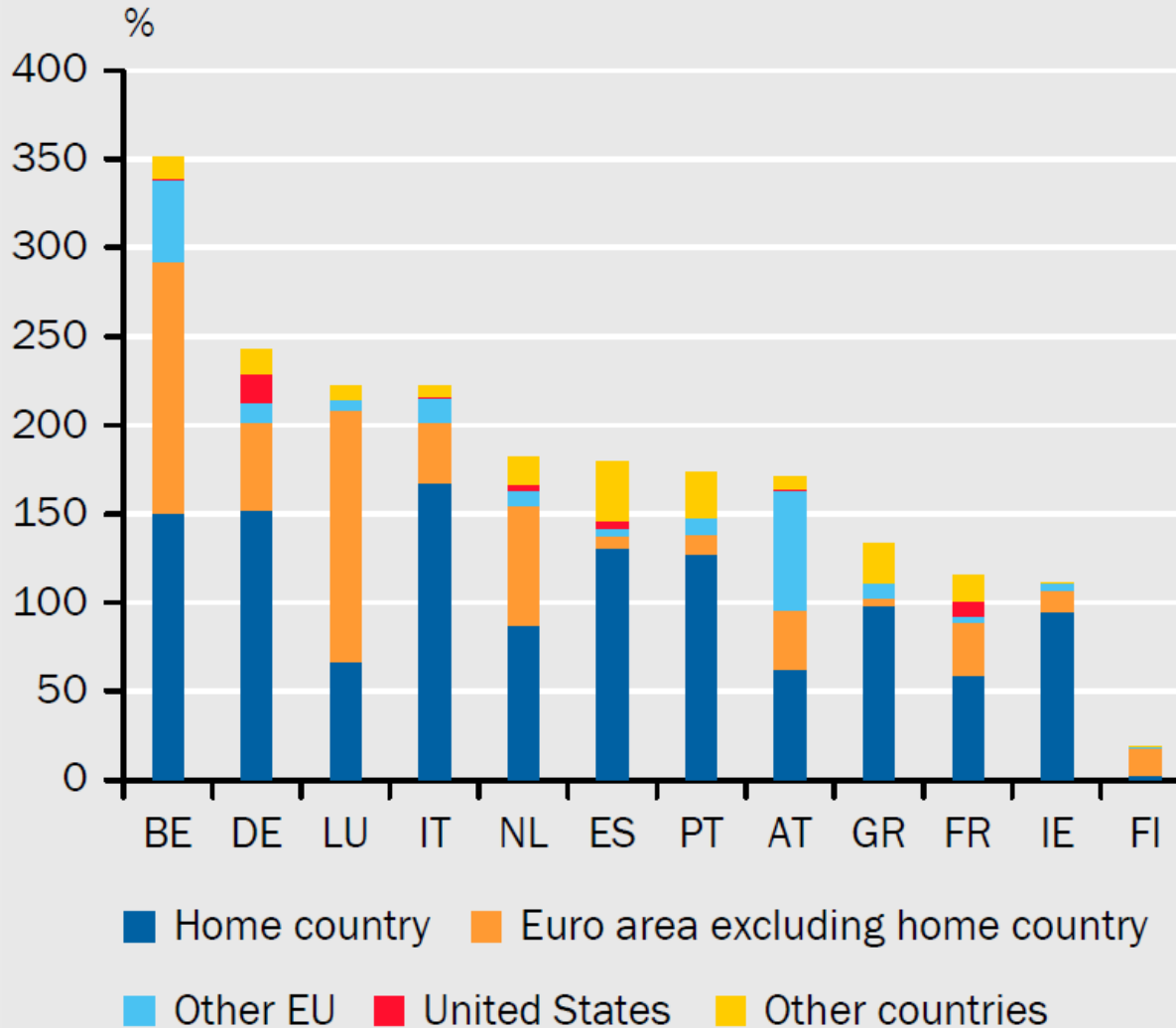
Breaking the sovereign-bank nexus

- Banking union: need to separate supervision from monetary policy, implement and strengthen SRM
- Removing privileges of sovereigns in banking regulations

Appendix: Concrete proposal for abolishing sovereign privileges in banking regulation.

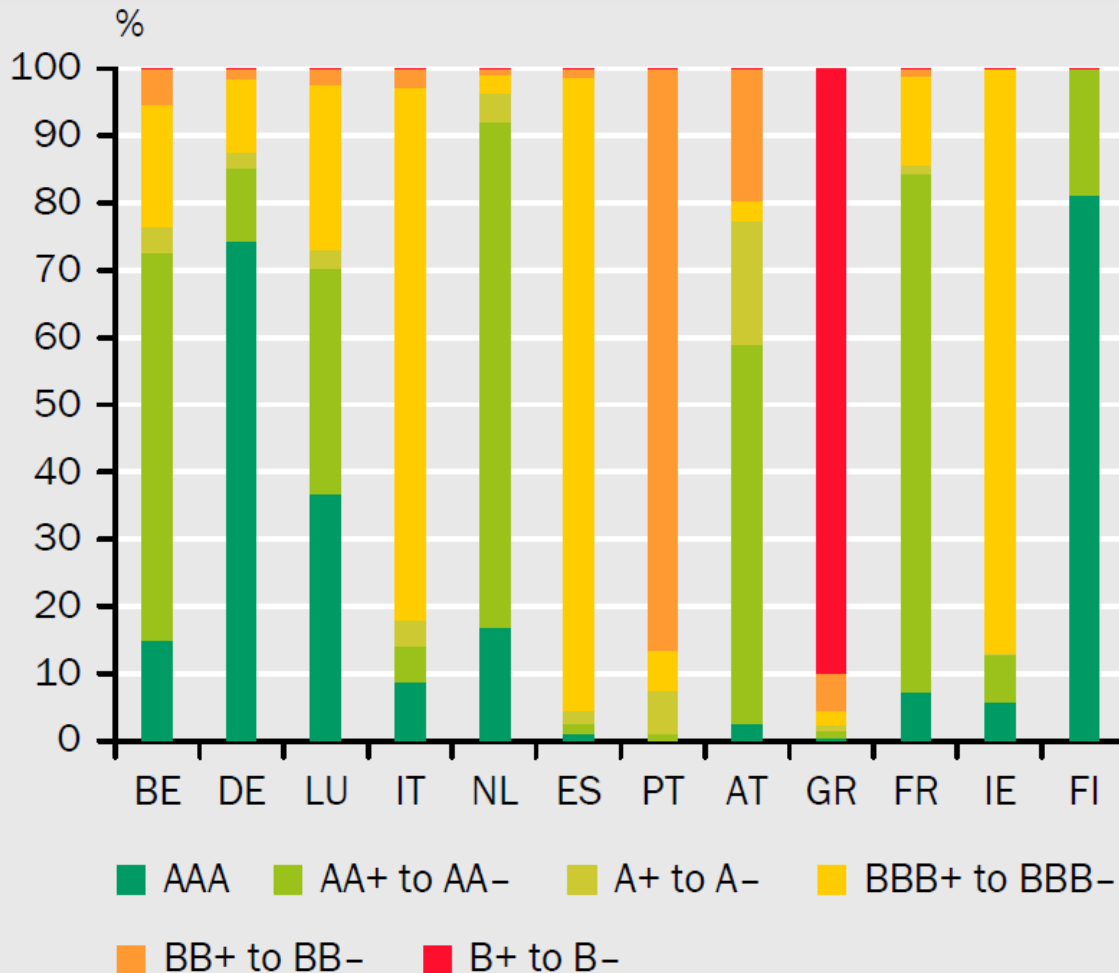
- Apply risk-adjusted large exposure limits to reduce home bias.
- Apply Basle risk-weights for sovereigns.

- Sovereign debt and banks: Home Bias



**Exposures
 to selected
 counterparties
 relative to
 own funds**

Exposures to EU members states



Exposures according to ratings

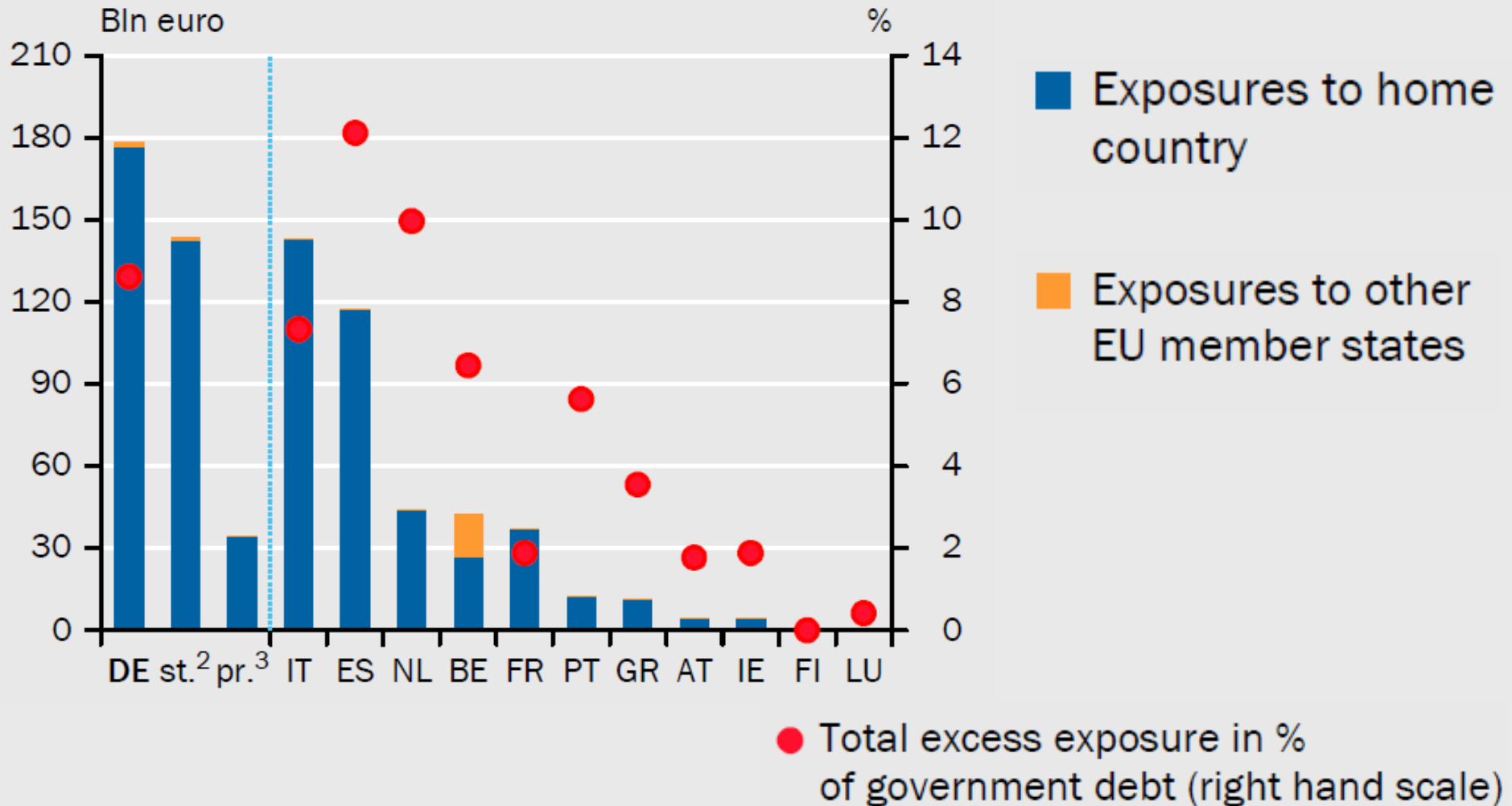
Concrete proposal

Risk-adjusted large exposure limits and risk weights for sovereign exposures

Standard & Poor's credit ratings ¹	Member states ²	Basel risk weight for sovereigns	Large exposure limit ³	Basel risk weight for corporations
		%		
AAA	DE, LU	0	100	20
AA+/AA/AA-	AT, FI, NL/BE, FR/EE			
A+/A/A-	IE/SK/LT, LV, SI	20	90	50
BBB+/BBB/BBB-	MT/ES/IT	50	75	100
BB+/BB/BB-	-/PT/-	100	50	
B+/B/B-	CY/-/-			150
CCC+/CCC/CCC-	-/-/GR			

1 – As of 1 July 2015. 2 – DE-Germany, LU-Luxembourg, AT-Austria, FI-Finland, NL-Netherlands, BE-Belgium, FR-France, EE-Estonia, IE-Ireland, SK-Slovakia, LT-Lithuania, LV-Latvia, SI-Slovenia, MT-Malta, ES-Spain, IT-Italy, PT-Portugal, CY-Cyprus und GR-Greece. 3 – Own calculation.

Exposure > risk-adjusted large exp. limits



Additional capital requirements due to risk-weights

