

A “No Further Bailouts” Principle

by Tito Boeri

Angela Merkel was right when she pointed out that there cannot be solidarity without control. She was also using the right words: “solidarity” and “control”. Whatever rescue package is ultimately agreed upon at the EU level to prevent the collapse of the Euro, it will unavoidably involve some solidarity transfer from the “triple A” countries to the “zero A” countries. The transfer can be concealed to please public opinion, just like transfers to the French agricultural sector under the CAP (Common Agricultural Policy) have for long been presented as generic subsidies to exporters and to environmental protection in rural areas, but it is a transfer. The switch from the EFSF (European Financial Stability Facility) to the ESM (European Stability Mechanism) has nothing to do with the size of the two funds. The ESM will at most mobilize 500 bn. Euros, 60 more than the EFSF. But contributions to the ESM (in addition to the initial 80 billion) will be guarantees or callable capital, not formally increasing the public debt of the different countries. However, these contingent liabilities are still liabilities that would materialise in case some country cannot pay its debt. Call them contingent transfers, but still it is solidarity or contingent solidarity.

Control is also the right word. Any sizeable transfer requires a change in the allocation of tasks within the Eurozone with a stronger role attributed to supranational authorities. This condition is ultimately imposed by German voters who continue to give a very high approval rating for *Merkel’s* conduct of the Eurozone crisis. Those arguing for unconditional solidarity are asking the German Chancellor to ignore these sentiments. She could actually try to save the Euro without saving her post, agree on solidarity without control, and then not run for re-election in 2013. But even supposing that the checks and balances of the German Constitutional system do not prevent her from acting as a *kamikaze*, would markets consider it as a commitment to a future line of action of Germany? How can they be reassured that the new Government will not undo the decisions of made by *Merkel* at the end of her mandate? It is true that she failed to prepare public opinion for the trade-offs involved by the Euro rescue strategy, but it is

too late now for her to prepare voters to support such a radical change in her strategy.

The real issue, thus, is what types of transfer of sovereignty are required to reassure the Germans, the Finns and, more broadly, the taxpayers with “triple A” ratings, and, at the same time, can be accepted in the countries at the epicentre of the crisis. It is not true that the countries facing a credibility crisis have no bargaining power. They are already getting very close to hitting their outside option. Austerity without progress in reducing the spread is making the situation unsustainable, and the recession in Southern Europe is way more painful than the Great Recession. It is entirely driven by a fall in domestic demand (while in 2008-9 it was driven by falling exports) and is associated with significant falls of disposable income (which did not occur three to four years ago even in the countries experiencing the largest output losses). Under these conditions, a Euro exit scenario may well become majoritarian if the rescue strategy is perceived as too demanding in terms of loss of sovereignty. Imposing too tough conditions would backfire: this is, after all, a historical lesson of another Treaty, the Versailles Treaty, that neither French or German voters are likely to forget.

However, there are far too many attempts to exert moral suasion on *Angela Merkel*, and no efforts in trying to persuade *Francois Hollande* and *Mariano Rajoy* that they should give up some authority and prepare their public opinions to this event. Leaders at the beginning of their mandate can affect voters’ preferences and even if they do not succeed in this, they can be credible while running against sentiments which are majoritarian in their constituency. They will have enough time to explain why this unpopular choice was necessary, and how it did prevent a far worse outcome.

Here is a criterion to select the kind of control which must go hand in hand with solidarity: there ought to be a transfer of authority to supranational bodies sufficient to make possible, in future, the default even of a large state without causing the collapse of the monetary and economic union. In other words, a “no further bailouts” clause must be credible under the new allocation of tasks between national and supranational authorities. This would reduce moral hazard, reassuring taxpayers both in the North (they no longer will have to intervene to save their overspending partners) and the South (their politicians will be forced to save for the future). It is, after all, a lesson from American history: a bailout of sovereign states (like the one decided in 1790 by *Alexander Hamilton*) must involve a regime change preventing a new bailout in the future (such as the 1840 decision of the US Congress not to allow for a new federal bailout).

Which type of delegation of authority to supranational authorities is consistent with a “no further bailout” clause? One of the pillars of the so-called banking union is perfectly aligned to this principle: the ECB should be fully in charge of surveillance over *all* banks (not only the largest ones) in the Euro area. This means that the default of a state in the Euro area need not be followed by a collapse of its banks. Another change in the allocation of tasks consistent with a “no further bailouts” principle is related to the setting and financing of a minimum guaranteed income scheme at the level of the Eurozone. This implies that, when a state goes bankrupt, there is still some transfer preventing absolute poverty, just as a default of the State of New York or the State of California does not prevent food stamps and welfare checks to be supplied to the neediest in the United States, independent of their residence. Another delegation of authority consistent with a “no further bailouts clause” is related to the removal of legal barriers to the mobility of people within the Euro area. This may require the adoption of a common migration policy *vis-à-vis* third countries as a single market for labour also implies truly common borders. If free mobility is actually granted, a state can default while leaving to its citizens the option to migrate and work elsewhere in the Union. Another transfer of control consistent with a “no further bailouts” principle relates to a common administration and enforcement of the value added tax. In addition to reducing cross border frauds, this would give to supranational authorities a rather powerful political penalty against governments with a poor record in reducing their debt. They will be visibly forced to tax more their consumers. This political penalty would come together with a fiscal devaluation which would also work towards reducing the national dissavings of those who over-spend.

There are clearly other forms of delegation of authority or loss of control of national Governments which are consistent with a “no further bailouts” principle. As the above examples indicate, they do not require the build-up of a transfer union. The world knows plenty of federations involving a very modest redistribution across states. Brazil, India and the US, just to give a few examples, all belong to this category. What matters now is to discuss pragmatically what will be the new allocation of tasks taking us out, in addition to solidarity, of the Euro crisis. Talking about economic and political union without redefining who should do what is nonsense. The document of the four Presidents (*Van Rompuy, Barroso, Juncker* and *Draghi*), presented ahead of the summit of 29 June 2012, was just too vague to be effective. No surprise that it was completely ignored in the final statement issued by the leaders of the Eurozone. Apparently, it will

become an issue paper for the autumn meetings. Let us hope that they are honest in presenting the trade-offs involved in any rescue strategy and that it will not be too late to discuss these issues effectively.