

# Europe After Brexit

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# I. Coping with fear: Some ancient consolation?

*"Nothing is more unreliable than the populace  
nothing more obscure than human intentions,  
nothing more deceptive than the whole electoral system."*

Marcus Tullius Cicero

# I. Fear: Danger of disintegration



# I. Coping with fear: Two camps

- **Stay calm. Contain spillovers and do NOT jump to hasty conclusions. The lesson from Brexit is NOT "more closer union"**
- **Wake up. Do now what needs to be done anyway: make the EU / Eurozone more robust, complete the architecture**
- **Danger. The two camps might entrench and engage each other and then do, too little too late**

## II. Solutions EZ: Desirable features of a robust long run framework

- **Fiscal regime: A credible commitment to prevent excess debt build up (or assumption)**
- **Financial regime: A diversified financial system that is not vulnerable to own sovereign risk**
- **Financial regulation has to be consistent with and reinforce the fiscal regime proposal**

## II. A robust long run framework, MEZ II, with Giancarlo Corsetti, Lars Feld, Ralph Koijen, Lucrezia Reichlin, Ricardo Reis, Hélène Rey

- **Fiscal regime:**
  - A ESM lending regime that sets limits to lending into doubtful debt dynamics (inside the boundaries of the IMF).
  - Credible limits help prevent debt crisis (ex ante incentives) Plus a mechanism to deal with them should they occur (limit power of holdouts)
  
- **Financial regime:**
  - sovereign risk weights (consistent with ESM parameters),
  - regulatory incentives to hold a diversified portfolio of sovereign debt
  - and to create a private safe asset through pooling and tranching

## II. Problem of transition

- Regimes that are stabilizing in the long run may be destabilizing in the short run because of the initial conditions (home bias and debt overhang)
- Example : Implementing a SDRM with a credible commitment device in a situation of excess debt can create a run on sovereign debt
- Example : Lift the exemption of sovereign bonds to limited exposure rules and/or sovereign risk weights can create sudden dislocations

## II. Attitudes towards the transition problem

- Ignore and deny
- Bank on the ECB (and bemoan the consequences)
- Wait for the long run and implement reform only then (but if announced now asset prices will adjust now)
- Solve the transition problem and implement reforms simultaneously (*Forge a deal that respects red lines*)

## II. Transition MEZ: A debt reduction

- One time operation, bring all countries out of the zone of vulnerability (debt below 90% of GDP (say))
- Buy back operation via stability fund (capitalize a small long term income stream, use as collateral to reduce debt now with newly issued stability bills)
  - Using only national resources (net present value of: future VAT, wealth transfer tax, seigniorage, petrol tax, ...).
  - temporary and limited transfers
- Debt equity swap (public/private): GDP indexed bonds

### III. Is this enough? Would it have prevented angry old men from voting for exit?

- No, this was a vote of no confidence on the EU not only EZ
- Technical issues :
  - No solution of NPLs
  - No fiscal stabilization function
- Deeper issues: Political and socio-economic shifts
  - Profound misunderstandings about the power of Brussels
  - The rise of populism on right and left
  - Is it the Precariat? (The new dangerous class, Guy Standing (2014))
  - And / or the aging median voters who are backwards bound?
- Even (macro)economist cannot ignore these risks (any longer)

**Thank you for your attention**