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Crisis Management in the EU, Prospects for the De-politicisation of Economic Policy

SUMMARY: The central question of the study is whether the reforms of European economic governance will resolve the problems which led to the current financial crisis. First, the responses to the crisis will be examined and then the paper will consider those proposals, which have been rejected so far as resolution for the crisis. By analysing the accepted and rejected measures, we can observe the strengthening of supranational technocratic decision-making at the cost of democracy at the national level. The limitations of such arrangements are illustrated by the experiences of Greek crisis management. The main conclusion of the study is that although economic arguments are very strong in favour of the creation of a fiscal union, a political economy perspective reveals that the success of such a union is strongly dependent on internal commitment to financial responsibility and external pressure cannot be a substitute for it.[1]

KEYWORDS: European economic governance, crisis management, Greece, democracy
JEL CODES: F34, F53, P16, Z18

As a result of the European financial crisis, previously unimaginable steps have been taken towards the de-politicisation of economic policy. These steps have led to areas being transferred to European control, which had previously fallen under the sphere of national competence. The purpose of the new regulations is to reinforce competitiveness and to regain market confidence by committing to fiscal discipline and to prevent the outbreak of another crisis.

The central question of my study is to find out whether the crisis management tools used are compatible with the objectives, meaning, is it reasonable to expect the disequilibriums to dissolve as a result of the measures taken. The most important assertion of my analysis is that in their philosophy the partially punishment based external force and partially voluntary rule abiding institutional system are very similar to the systems that were in place before the crisis; therefore, they are just as unlikely to be able to reduce the dangers arising from moral hazard as their predecessors. This means that the danger is still present that the debt will not necessarily be paid by the person who had taken it on, which might encourage players to behave irresponsibly.

In presenting my thesis, I would first like to present the measures and institutional reforms that have been introduced to manage the crisis. When assessing the steps it is important to see which measures met widespread resistance. The effort to de-politicise the whole realm of economic policy and to remove it from the scope of democratic control is revealed when the two aspects are assessed together. I shall prove the limitations of this approach with the lessons learnt from Greek crisis management.

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At the end of this study I shall draw conclusions about the future of the fiscal union.

RESPONSES TO THE CRISIS

In light of the European crisis, one of the gravest errors of the establishment of the euro area was the lack of crisis management mechanisms, which deficiency became clear during the management of the Greek crisis. The original ideas of a single currency formed an impossible trinity with no bailouts, no national bankruptcy and no exit.[2] The crisis made it necessary to review this situation. As there was no plan to address the problems, the solution took shape gradually through agreements concluded at European Council summits and through interventions by the European Central Bank (ECB). In the following, I will briefly present the most significant steps taken in the interest of handling the crisis.

Establishment of crisis management funds[3]

The first step of crisis management in May 2010 was the establishment of the European Financial Stability Facility (EFSF) available to the Member States of the euro area to alleviate financial difficulties subject to strict conditions. The facility disposes over EUR 440 billion in funds, which the Member States guarantee in proportion to their share in the reserves of the ECB.

The European Financial Stability Mechanism (EFSM) also entered into force in May 2010, which is available to every EU Member State to alleviate financial difficulties subject to strict conditions. This facility disposes over EUR 60 billion and is guaranteed by the common budget of the EU.

The European Stability Mechanism (ESM) replacing the previous two came into being on 27 September 2012 and can be used by the Member States of the euro area and their banks to alleviate their financial difficulties under strict conditions. According to the plans, the EUR 500 billion in lending capacity is going to be comprised of the EUR 80 billion in Member State contributions and loans taken out against Member State guarantees.

The crisis funds fill a significant gap in the institutional system of the euro area and make it possible to provide assistance in an organised manner to countries that have run into trouble. In their assessment, however, it is important to note that the funds at their disposal are obviously insufficient if the crisis were to spread. The Italian government debt is roughly 2,000 billion euros, whereas the Spanish government debt is around 800 million euros. *De Gauwe* (2012) also asserts that as a result of the limited nature of the funds, the usual speculation issue may arise as well, meaning that investors could attack the fund and sell its bonds before it could be fully depleted. Under such conditions, expectations could very well prove to be self-fulfilling. All of this is especially true, if we take into account that the more countries need to be bailed out the fewer countries remain to shoulder the costs thereof. It is no coincidence that in July 2012, Moody's has downgraded the stable outlook of Germany to negative, because Germany could not bear the burden of bailing out the entire euro area even if it wanted to.

These problems indicate that setting up bailout funds is not sufficient in itself to resolve the crisis. The interventions of the ECB were also a key component of the management of the crisis.

Interventions of the ECB

Since the eruption of the crisis, the ECB has intervened in many ways and on many occasions to restore confidence. Two of its most important steps were the government security buy-up programme and the three-year long-term refinancing operation (LTRO).[4]

Until February 2012, the ECB bought 219.5 billion euros worth of government bonds from periphery countries, which had been pushed out of the international money markets due to the associated high risk. Because the bond buy-ups occurred on secondary markets, strictly legally speaking, the ECB did not break the rule that says it is prohibited from directly financing any of the states; however, the step clearly goes against the principles underlying these rules.[5] Although the programme was suspended in February of 2012, responding to increasing market and state pressure, the ECB announced a new unlimited government bond buying programme with the purpose of reducing the premium for periphery countries. Although in the short term this step may calm the markets, it carries significant long-term risk; it may undermine the trust placed in the independence of the ECB, and the continued financing of the periphery may also raise the issue of moral hazard.

Similar considerations are valid in connection with the LTRO as well, under which the ECB granted 1,018.7 billion euros worth of secured loans in two rounds to banks in peripheral countries at one per cent interest for a tenor of three years in order to counteract the depletion of market funds. In addition to the danger of inflation this step also means that there is no need to restrain consumption or engage in fiscal reform. The lack of structural changes in the periphery is also apparent in the unchanged deficits of balance of payments on current accounts (Tornell and Westerman, 2012). *Wyplosz* (2012) considers the liquidity improvement measures of the ECB to be a 1,000 billion bet which might turn out all right in the end, but one that is extremely risky—because it could be an additional cost for taxpayers to shoulder in the case of a bank bailout, which could occur if banks are forced to write off amounts invested in government securities in the event of a sovereign default.

Write-off of Greek Debts

For Greece neither the bailout funds, nor the interventions of the ECB proved sufficient. As a result of the failure of crisis management, which I am going to describe in more detail in the next part of this paper, it became apparent that the country can either secede from the euro area or declare bankruptcy. The decision was to announce partial default, which occurred in February of 2012; the country received a second EU–IMF bailout and private investors wrote off 53.5 per cent of the Greek government securities in the form of a voluntary debt swap.[6] After this step was taken Greek debt fell below 120 per cent of GDP and Greece stayed in the euro area.

After debt write-off investors now have to face the possibility that this is not a one-time step. In the long term, this was a significant step towards minimising moral hazard, although in the short term it heightened distrust of peripheral countries.

Institutional reforms

Apart from the immediate measures the EU has also enacted several institutional reforms, which aim at improving economic governance.[7]

The *European Semester*, established to reinforce economic control and coordination in September 2010, integrates the inspection of fiscal and structural reforms and provides guidance to national economic policy before decisions are made. The reform substantially strengthens the role of the Commission, which is responsible for its oversight.

The *Euro Plus Pact* signed in March of 2011 serves to improve competitiveness by harmonising economic policy, making competitiveness, employment, and public administration systems sustainable and by reinforcing financial stability.[8] The Pact is based on an open method of coordination, which means that implementation will stay at the national level, i.e. the EU will not be allowed to force nations to carry out reforms. The lack of force and punishment, however, means that if a country does not want to implement these measures they are not going to. The first evaluation on the operation of the Pact was published in November 2011 (Schmieding et al., 2011), which shows vast differences in progress. The greatest steps forward have been taken by the countries which had to be bailed out. The countries where this was not necessary, such as France and Italy, are significantly behind in terms of their reform efforts.

The package of six measures – which entered into force in December 2011 serves to reinforce the Stability and Growth Pact – can compel countries more efficiently through a system of quasi-automatic measures. In this respect it can be asserted that reversed voting will not, in and of itself, change the situation that it is still ECOFIN that has the last word and the authority to hand down judgement, and that it is possible to engender alliances to avoid punishment even with reversed voting in place. In addition to punishment based force, this also means that the possibility of cost-benefit analysis still exists, depending on the political climate within the country, meaning that the political weight of punishment largely depends on the legitimacy of the EU. Where national politicians use the EU as a scapegoat when they want to introduce painful measures, the warnings and punishments handed down by the EU may easily lead to results contrary to their intended purpose. Therefore, more stringent rules do not necessarily translate into more efficient force.

One of the novel features of the package of six was the introduction of the macro-economic disequilibrium procedure, within the framework of which 10 indicators are assessed on the basis of pre-defined benchmarks. If disequilibrium is present in the country and despite warnings the country does not take steps to amend the situation, it may be fined. Three important reservations may be formulated in connection with this feature. Firstly, it is highly questionable whether it is reasonable to use the same benchmarks in countries at vastly different ends of the development spectrum, for example in connection with balance of payments or private lending-professional consensus is completely absent in these questions (Neményi and Oblath, 2012, p. 652). As a result, the debate on the benchmarks of the Stability and Growth Pact may spark up again, which can considerably hinder the Member States' willingness to comply. All of this then leads to the second problem, which concerns the limitations of knowledge. Whereas before the crisis, even the existence of bubbles was called into question,[9] after the crisis accurate indicators are being set up which might serve as the basis of punishment. This is especially important in that the warning systems that are designed to forecast coming crises – which are very similar to the system of indicators created by the EU – are only mildly successful in their ability to forecast.[10] In addition, *Scharf* (2011, p. 189) warns that as opposed to deficit and public debt figures, national governments have no direct effect on excessive disequilibrium indicators such as unemployment or the changes in housing prices. As a result, this calls into question whether it is fair to mete out punishment for these.

The Agreement on the Stability, Coordination, and Governance within the Economic and Monetary Union signed in March 2012 also serves the purpose of further reinforcing fiscal discipline, and, among other things, it prescribes a deficit target of 0.5 per cent of the GDP[11] and also requires the signatories to record their commitment to fiscal discipline in their respective constitutions. The main problem of the Pact according to *Sawyer* (2012) is that the 0.5 per cent threshold cannot be justified by macro-economic considerations and, based on real-life experiences, deficits in excess of that did not necessarily lead to an increase in debt. Another problem is that there is no well-founded calculation method, as the determination of potential output is seriously limited.

Overall, it can be established about crisis management measures that the euro area did not collapse and none of the countries were forced to exit it. With these steps, the decision makers sent a message to the markets, asserting their commitment to the requirements of financial discipline. The measures that have been taken in the interest of managing the crisis can be criticised in several respects and show very well that the reforms do not reflect well thought-out plans, rather they are a set of attempts to calm the markets. Before, however, delving further into their assessment, it is important to take opportunities into account that were rejected in the heat of the crisis. I shall examine three possibilities in the next part of this paper: exiting the euro area, euro bonds and the transfer union.

REJECTED SOLUTIONS

Exiting the euro area

It was mentioned in connection with the Greek crisis that it would be perhaps better to just exit the euro area. This did not happen as of the time this paper was written (October 2012), although the possibility cannot be fully excluded.

From a Greek point of view, one of the most important reasons for the Greeks to exit the euro area is that they would have the opportunity to create their own monetary policy, i.e. devaluation could restore competitiveness. In addition to the recession the combined effect of financing limitations and a devaluating currency would significantly restrain imports, strengthen exports and trigger the adjustment of the balance of payments. In addition, there are also arguments for the fact that these steps would improve the credibility of the euro area, because a problem country would be removed from the system.

However, the resulting costs would outweigh any advantages gained. The significantly devaluated currency would seriously increase the value of the debts denominated in foreign currency. The private sector almost certainly would not be able to pay its debts, but the debts of the government could be restructured.[12] The wave of private sector bankruptcies and the partial default of the government would take the banking sector with it as well, which could only be bailed out by printing money. These processes taken together generate enormous inflation, which depreciates the value of savings and would seriously limit financing. In turn, sharply increasing inflation would weaken the coordination mechanism function of prices, meaning that economic calculations would become considerably more difficult. Based on all of this, according to the calculations of the IMF, the recession would be above 10 per cent in the first year (IMF, 2012, page 46). In addition to these it should not be ignored that devaluation would not be able to solve the structural problems of the Greek economy.[13] One must also not forget that the economic crisis would presumably not stay economic in nature, rather it could quickly turn into a political crisis – the collapse of the state would trigger riots, street violence, and in the worst case scenario civil war.

The euro area Member States would not be left without having to bear additional costs if Greece or any other Member State decided to secede. The exposure of the euro area to Greece is around EUR 300 billion. Paradoxically, the smallest loss would be incurred by the biggest investor: Germany, because it is only able to obtain funds on the markets at negative or very low interest rates (Alcidi et at., 2012, p. 5). Greece's secession would have the worst effect on the rest of the Mediterranean countries, which would on the one hand suffer from the loss of market confidence, and on the other hand would also be involved in the write-off or restructuring of the debt – they could only replace the amounts they had paid into the European bailout packages with high interest premiums. Based on these considerations, the possible Greek default is frequently referred to as Europe's Lehmann bankruptcy.

As a result of the consequences listed, secession met with rejection as of the writing of this study – with the exception of extremist parties, both the Greeks as well as the rest of the Member States of the euro area expressed their commitment to maintaining the euro.

Eurobonds

The second, so far rejected, solution would be to issue eurobonds, which would mean that a part or all of the public debt would be issued jointly. According to *Claessens, Mody* and *Vallee* (2012, p. 4), this step would provide a solution to three different problems of the euro area.

❶ *Budget:* Joint bond issue would mean that the financial risk would be shared by the euro area Member States, and the countries on the periphery would be able to obtain loans at lower interest rates. In addition, the related institutions – such as a European Ministry of Finance – would make it possible to impose a greater degree of discipline on the Member States.

❷ *Financial stability*: joint debt issuing would help separate the problem of the banks from the budget and liquidity would be ensured in the event of a crisis, which would reduce the speculative pressure as well.

❸ *Monetary transmission*: Joint debt issuing would improve the effectiveness of monetary policy and would reinforce financial integration. As a result, the euro would turn into a real international reserve currency, a true rival of the US dollar.

The main argument against joint debt issuing is that the system carries significant moral hazard. This means that the debt will not necessarily be paid by the person who had taken it on, which encourages players to behave irresponsibly. Cheap access to loans would also give way to delaying structural reform – very similarly to how it was before the crisis, due to interest rate convergence. Finally, spending public funds on financing other countries goes against the principles of democracy and the constitutions of several Member States (Csaba, 2012, page 69).

Due to moral hazard, and in connection with the euro bonds, it is especially significant how it is going to be created. There are currently numerous concepts on the table on the issue, which try to mitigate the danger of the moral hazard by differentiating in terms of the extent of the debt, debt maturity, or by restricting access to joint debt.[14] The official position of the EU is the plan, commonly referred to as the Bank Union, which sets the stage for the common European bonds after common financial regulation has been achieved and fiscal decision-making has been integrated (European Council, 2012).

Overall, from an economics point of view there are numerous arguments in favour of the common bonds. However, due to the possibility of moral hazard, it is also obvious that in the net contributor Member States, from which the plan expects the largest contributions, especially in Germany, this idea is met with strong opposition.[15]

Transfer Union

The third solution, which also faces opposition, is to raise the common budget, under which both the revenues and the expenses would be decided at the supranational level. This would mean that certain social security benefits, such as the unemployment benefit would be transferred to the European level (Guérot and Klau, 2012, p. 5). This could help prevent the budgets of states from completely capsizing-currently in the countries that are in a recession, revenues are decreasing whereas spending on unemployment benefits is increasing. A similar thought in connection with the Bank Union is a fund to be created to jointly finance deposit guarantees, which is partially met by the establishment of the ESM. In terms of the solution of the crisis, the strongest argument for this is the reinforcement of the criterion of the optimal currency area: the re-allocation of funds from the prosperous regions to the crisis-ridden ones promotes adaptation to the developing asymmetrical shocks. Currently, this is only realised to a limited extent through the regional and cohesion funds.

In addition to the theoretical advantages, however, the disadvantages are also quite clear. What is most important is that this could lead to a reduction in the motivation of the peripheral countries to implement structural reform, which in turn, could develop into transfer dependence. The experiences of Eastern German states show how all of this can lead to a long-term disadvantage and falling behind (Orosz, 2009). The issue of democratic legitimacy is also very important, which also arose in connection with the euro bonds-taxes and spending reflect values, which cannot be removed from democratic control. Without a political union the centralisation of revenue and expenditure would create strong tension in countries with vastly different cultures.

Tightening the budgetary and political union is featured as one of the tasks to be implemented in the future in a proposal of the European Council (European Council, 2012). However, the realities are well reflected in the current debate on the next seven-year budgeting period (2014–2020) – the net contributors are adamant that the budget not exceed one per cent of the EU's gross national income (GNI).[16]

AN ATTEMPT AT THE DE-POLITICISATION OF ECONOMIC POLICY

Overall, based on a review of the adopted and rejected solutions, it is obvious that there is great resistance to solutions employing open re-distribution. In contrast, it is also obvious that the adopted solutions nonetheless employ re-distribution, albeit in a rather opaque way and often in sharp contrast with the original concepts about the euro area.

One of the most significant critiques of the solutions is that the moral hazard present even before the crisis has become greater-meaning that investors' expectations that bad debtors will be bailed out and that there is no risk for them to bear, has mostly become a reality.[17] European decision makers are obviously aware of the problems of moral hazard – this is why in net contributor Member States, there is significant political pressure to discipline countries in debt.[18] Over the course of institutional reforms, the rules became considerably stricter and cover significantly more ground than before. The success of their operation would be crucial in order to minimise the problem of the above discussed moral hazard.

With respect to operation, enforceability still remains doubtful. This is most apparent in the case of the competitiveness pact, where an open coordination mechanism only facilitates implementation if intrinsic commitment is present as well. It is similarly obvious that the punishment based force of the package of six is just as questionable, because compliance with the rules may still be subjected to a cost/benefit analysis.

However, crisis management, which does not appear to plan for the long-term, shifts power relations within the EU in a quite clear direction. In the wake of the measures aimed at avoiding the dangers of moral hazard, the European Commission is increasingly diverting competences to itself over national level economic policy. Although, this is always coupled with emphasis on commitment to democratic decision-making, we are nonetheless witnesses to the contrary. This is true for the lending and borrowing countries as well. While in the former the nations have little say in how to use the taxes being used as bailout money, the latter have to contend with not being asked about the conditions of the bailouts.

Based on this, the adopted solutions are basically pushing towards the increasing de-politicisation and escalation of economic policy to the supra-national level. This means that the competent bureaucrats define economic policy solely on a professional basis and not a political one, and remove economic policy from the democratic decision-making process. Instead of the input side, i.e. electoral participation, in this case legitimacy is provided by the output side, meaning the ability of the organisation to provide effective responses to problems that require a common solution (Scharf, 1999, pp. 11–12).

Emphasising output-side legitimisation is not necessarily an idea to reject, as for instance *Rothstein* and *Teorell* (2008, p. 169) argue that with respect to legitimisation, the output side is significantly more important than the input side. Two questions arise in connection with the solution. Is there such a thing as economic policy free of politics? If there is, can it be enforced from a supra-national level? These questions are critical because if the answer to any of them is negative, then after the crisis moral hazard will become the determining factor in spite of institutional changes.

Of the two questions, I will be dealing with the second one. Though plenty of reservations could be formulated with respect to the first question as well,[19] I am proceeding on the premise that compared to politicians of the periphery who have short time horizons and concern themselves only with their re-election, EU bureaucrats are actually capable of formulating an efficient economic policy programme that is based on international best practices. The question is whether they are able to have these implemented.

I would like to present the relevance of the problem through the experiences of Greek crisis management, where the extent of external pressure on the country is so great, that it will probably not be seen anywhere in Europe despite the strictest institutional reforms. If in this case bureaucracy is unable to succeed, then success is even less probable in other cases, where external force is less severe.

THE LESSONS LEARNED FROM GREEK CRISIS MANAGEMENT

The crisis of the euro area began with the Greek crisis. Initially, the Greek crisis was far from obvious as though there had been regular disequilibriums, growth had been high for a decade. Furthermore, there were no toxic securities in the Greek economy.

The outbreak of the crisis is considered a prime example of political opportunism. At the October 2009 election, New Democracy, which campaigned for a strict budget policy, lost to the Socialists (PASOK) who promised increased spending and greater welfare allowances. The election was won by the latter which, after the inauguration, announced that the deficit will be 11–12 per cent of GDP, significantly higher than the previously expected 6–8 per cent. Part of the deficit served to set up a so-called solidarity fund which in 2009 already distributed EUR 800 million to those in need (Visvizi, 2012, p. 21).

However, the strategy-intended for internal political use-had catastrophic consequences. The sustainability of the financing of Greek public debt was thrown into doubt due to the huge deficit, and this was manifested in immediate downgrading. Mid-crisis, highly anxious investors turned away from Greek securities and expectations became self-fulfilling; by the end of the year, Greece was effectively shut out of international money markets (Ardagna and Caselli, 2012, p. 4).

Instead of providing real answers, Greek politics initially blamed speculators for the problems and took until January to actually put some sort of reform programme on the table. The solidarity fund, however, was not eliminated and they also planned to implement the adjustment primarily by raising taxes (Visvizi, 2012, p. 22).

Initially, the EU was averse to having a euro area Member State turn to the IMF and finding a solution took until spring. According to *Ardagna* and *Caselli* (2012, p. 5), compared to similar adjustments, the May 2010 agreement that provided a loan of EUR 110 billion to Greece set a realistic deficit reduction path; it planned to reduce the 13.6 per cent deficit in 2009 to under 3 per cent by 2014.

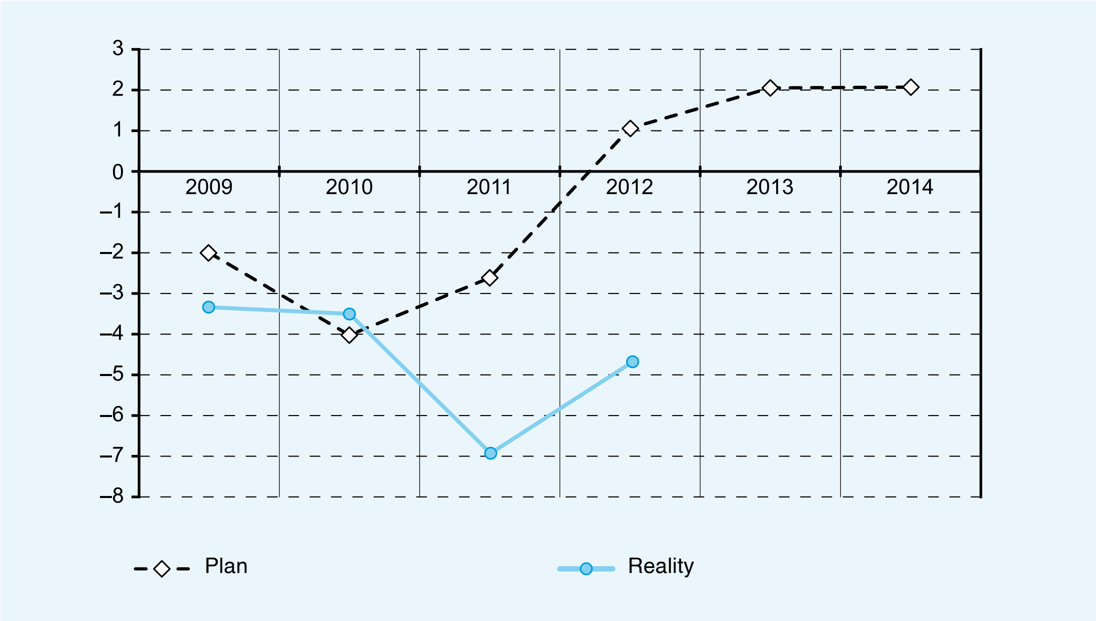
The package, however, was insufficient to regain investor confidence and Greece was unable to return to market financing. According to Ardagna and Caselli (2012, p. 10), two factors contributed to this: firstly Eurostat published a revised estimate of the 2009 deficit which placed it at 16 per cent, and secondly, the Irish bailout package also made markets anxious.

In the opinion of *Visvizi* (2012, p. 31), however, market prudence was very much called for due to the composition of the adjustment, which was made up of revenue increasing and expenditure lowering measures in equal parts. The Socialist government focused primarily on the collection of taxes. The structural problems of the Greek economy-state companies generating huge losses and an inefficient public sector-were relegated to the background. The focus on raising taxes significantly lowered company profits and was an obvious counter-incentive for new investments. The privatisation programme aimed to sell a minimal share of state-owned companies; however, this is difficult to view as an appealing investment when these companies are still under state supervision.

The failure of Greek crisis management illustrates the consequences of bad governance, which can be considered one of the root causes of the crisis. According to *Featherstone*'s analysis (2011, pp. 195–198), in Greece four major factors contribute to this outcome. As the winning party primarily considers administrative positions as spoils of war, the aspects of expertise are relegated to the background. The institutional system regulating the collection and spending of public funds is extraordinarily weak; corruption is present in both the (non)-collection of taxes and expenditures. The majority of unions represent the workers of the public sector, which stand for extremely rigid employment regulations; the ensuing structural unemployment is offset by an enormous informal sector. Finally, the population relies heavily on the state in terms of the various services. This means that pro-market reforms have very little support, meanwhile the state perches on top of the economy; its inefficient and expensive services making the country uncompetitive.

Chart 1

CHANGE OF PLANNED AND REALISED GROWTH (2009–2014)



Note: the plan stands for the growth path outlined in the 2010 stand-by loan. Of the realised data, the 2012 data is a forecast.

Source: Ardagna and Caselli (2012, p. 27), European Commission (2012, p. 48)

Chart 2

CHANGE OF EMPLOYMENT IN THE PRIVATE AND PUBLIC SECTOR (2000–2010)

Source: IMF (2012), p. 62

Based on the problems described it is clear why the two crisis management packages could not have been successful; they were trying to make up for the losses of state-owned companies through higher taxes, but at the same time little effort was made in the fields of liberalisation and privatisation. The expected boom was never realised, with continuing recession, increasing unemployment, declining state revenues and increasing expenditures becoming typical instead. In this situation, the decline in growth was significantly greater than expected (*see Chart 1*), while the burden of the drop in employment was primarily born by the private sector (*see Chart 2*).

The results do a good job of illustrating the limits of external force in implementing structural reforms. Even at the time of the most intense pressure, the Greek political class was able to partially enforce its own preferences and delay reforms it found painful. Obviously, this did not result in any favourable outcomes, yet it still makes it clear that without internal commitment, external force can initiate deep-rooted changes only to a very limited extent.

CONCLUSIONS

The main question of my study was to what extent do institution changes within the EU remedy the causes leading to the crisis. In order to answer this question, I reviewed the crisis management steps, as well as the measures which proved to be too radical even at the time of the crisis. The main conclusion of the review was that during a time of crisis management we are witness to an extraordinary intensification of moral hazard that institutional reforms will probably not be able to offset. The limits of structural changes due to external force are well illustrated by the example of Greece.

The paper does not challenge the view that there are serious economic arguments for the deepening of European financial integration, during which well-performing regions help those in trouble. Eurobonds or a single bank bailout fund could provide solutions to this problem. In order to avoid transfer dependence, in the interest of realising the above, the management of related moral hazard is unavoidable and the current institutional system cannot be considered much of a guarantee in this respect.

Even though forecasts in social sciences have limited validity, based on the contents of the paper, we can expect times of crisis and disequilibriums in Europe to persist. These may take on a number of different forms, and there is also a possibility that the ECB will resort to easing up on inflation as a means of reducing debts. If this comes to pass, we will be reliving the 1970s when inflation and stagflation were present simultaneously.

Notes

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2 For a thorough exposition of the problem, see Benczes (2011)

3 The following section draws heavily on the summary by Neményi and Oblath (2012), p. 658

4 For more information about the steps see MNB (2012), p. 13

[5] This position was also underscored by the departure of Jürgen Stark as former Senior Economist of the ECB, and the resignation of Axel Weber, former governor of the German Bundesbank. See the report on the resignations and the critique of the measures taken by the ECB in the media at: http://www.telegraph.co.uk/finance/financialcrisis/9560102/ECB-in-panic-say-former-chief-economist-Juergen-Stark.html

[6] Please see IMF (2012, p. 45) about the details of the Greek debt write-off.

[7] Unless otherwise indicated, the source of reform descriptions is Neményi and Oblath (2012), pp. 645–663

[8] Citing reasons pertaining to national sovereignty the Czech Republic, Hungary, the United Kingdom and Sweden did not sign the programme.

[9] Before the crisis, the so-called Greenspan doctrine was the authoritative stance taken in central banks, according to which building on the efficient market hypothesis, intervening in bubbles was undesirable. The hypothesis posits that a central bank has no informational advantage compared to the market players, i.e. it is unable to detect a bubble during growth. Moreover, even if it had the ability to do so, changes in the interest rate would not be able to stop the bubble from forming, but would result in significant damage to the other sectors of the economy. See Mishkin (2011), pp. 17–21

[10] See Berg et al. (2004) for a detailed assessment of the crisis forecasting models.

[11] Structural deficit means that the deficit is not calculated on the basis of the current, but rather on the basis of potential output, meaning that cyclical and one-off factors are not taken into consideration (Sawyer, 2012, page 1).

[12] See the analysis of Alcidi et al. (2012) about the costs of a possible Greek default.

[13] This topic will be discussed in detail in the next section.

[14] For a detailed summary of the various ideas, see Claessens, Mody and Vallee (2012).

[15] See the open letter of 172 German economists in the Frankfurter Allgemeine Zeitung of 5 July 2012. Available at: http://www.faz.net/aktuell/wirtschaft/protestaufruf-der-offene-brief-der-oekonomen-im-wortlaut-11810652.html.

[16] See a detailed analysis of the recommended plan under Bajusz (2012).

[17] According to Ardagna and Caselli (2012, p. 9), in the event that Greece were not bailed out, it would have been inconceivable for the banks holding Greek debts not to be lent a helping hand afterwards. If these banks were bailed out, they would probably have continued to provide loans to risky countries with preferential conditions.

[18] This position is represented most vehemently by Germany. A detailed elaboration on the German position is provided by Dullien and Guérot (2012).

[19] As the system of multiple objectives (allocation, redistribution and stabilisation) is a given due to the nature of budget policy, it cannot be optimised in the same manner as monetary policy, where until the outbreak of the crisis, few disputed the treatment of price stability as a priority objective. Due to the system of multiple objectives, deciding between the various goals is not a question of economics, but a choice between values, which constitutes a political decision.

Literature

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