Workshop
“The current state of finance in the EU: Prospects and alternatives”

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ABSTRACTS

- **Judith Dellheim**

“The EU as a producer of causes for financial crises – what can be a productive debate on left alternatives, and what could be meaningful left alternatives?”

On the one hand, EU law and, moreover, the whole of the EU really are among the causes of global financial crises, on the other hand, EU law, as it exists, as well as the real possibilities the EU could offer for dealing with the current global financial crisis have not really been made use of for dealing with the on-going global crisis. Any effective debate on realistic alternatives must start from here, while avoiding the trap of a false problem: Either to overlook the problems of the EU construction and the capitalist mode of production or to discuss these only in general, unavoidably abstract terms, while overlooking the specific real power relations and the existing possibilities to act politically in the given historical situation. The presentation will be based especially on an analysis of the crisis management of the ruling forces, as well as on the Memorandums presented by the EuroMemo Group.

- **Gary Dymski**

“The US-EU Financial Paradox and the Crisis of Europe: Interconnected Balance Sheets, Disconnected Risks”

Since the creation of Eurodollar markets in the immediate post-war period, European and US finance has been interconnected. Initially, this connection involved the rise of Eurodollar markets and lending outside the locus of formal US regulatory control. These developments facilitated US banks’ use of Eurodollars to make large loans to commodity-intensive less developing countries (LDCs), especially in Latin America, and facilitated US banks’ recovery from the loss of blue-chip US loan customers to direct credit markets after the mid-1970s. This occurred through a Europeanization of the offshore portions of US banking: that is, soft-touch regulation coordinated by well-networked insiders substituted for the hard-and-fast balance-sheet ratio rules favoured in the US system.

After deregulation, and with the rise of a systematic US current-account deficit, global capital flows tilted to the US and facilitated the rise of securitization – that is, the ‘originate to distribute’ model of loan-making. As first the plain vanilla mortgage market was pulled into securitization, and then subprime loans. Revenues from fixed-income instruments and the panoply of derivatives linked to them skyrocketed. These new markets exploded, fuelled by global deregulations and rising global cross-border capital flows. The coming of the European 'single market' led national-champion European banks to reach for size and scale, and this meant – in many cases – participating in this Americanization of credit markets, participating in wholesale underwriting, bundling, and hedging markets. This threw the viability of the long-established 'relationship-based' lending approach of European banks into question just before the implosion of the subprime markets and many of the institutions that had dominated them.

Ironically, while American banks pioneered the new risks, European banks were most badly scarred in this extended crisis. Post-crisis, US investment banks are dominant globally; , large continental banks have lost competitive ground, while the strategic direction of City of London financial firms is now thrown into doubt by the extreme uncertainty surrounding Brexit. But the competition to attract London-based financial business to EMU-based financial centres has weakened the resolve in Europe to rebuild financial-system functionality and to control the sources of financial instability. Meanwhile, as the recent work of Adam Tooze emphasizes, the contrast between the costly bailouts provided to megabanks during the crisis and the austerity policies that followed the crisis, together with the pressures exerted by the immigration crisis and the unsuccessful efforts of the France/Germany nexus to develop coherent Europe-wide fiscal policies has jeopardized the elected governments of many European nations; this conjuncture now poses an existential threat to the future of the EMU, and more broadly to the European project as a whole.

Resolving the dysfunctionality and excessive riskiness of European banking will not guarantee the survival of Europe; but European households and businesses need a economically functional banking system for the European project to continue. The more hesitant are participating nations to agree to intra-European surplus transfers, the more important it is that a functional European banking system finance investment and sustainable consumption across the continent. In this context, it is crucial to consider how to align risks with balance-sheet commitments in European banking. This will require pulling back from the deep integration with US financial markets that led to the crisis, as well as developing sustainable Europe-wide banking practices. This paper explores how the EU-US financial paradox – the continuing pattern wherein excessively risky innovations largely generated in the US end up doing operational damage primarily to European banks and to the coherence of European finance – can be resolved; and it considers the role such a resolution might play in assuring the future of the European project.

- **Apostolos Fasianos and Anastasios Evgenidis**

"Monetary Policy and Wealth Inequalities in the UK: Assessing the role of unconventional policies for a decade of household data"

The UK is currently witnessing increasing levels of wealth inequality. This paper explores whether unconventional monetary policy operations have redistributive effects on household wealth. We contribute to the inequalities literature as follows: drawing on the Wealth and Asset Survey, we construct monthly time series indicators on the distribution of different asset types held by UK households for the period preceding and following the Global Financial Crisis (2006-2016). Using this series, we estimate the response of wealth inequality on monetary policy, taking into account the effect of unconventional policies conducted by the Bank of England after the Global Financial Crisis. Our evidence suggests that QE shocks have significant short-term effects on wealth inequality: an expansionary monetary policy in the form of asset purchases raises wealth inequality across households, as measured by their Gini coefficients of net wealth, housing wealth, and financial wealth. We also carry out a counterfactual experiment for the QE period. By comparing the simulated path of the net wealth Gini coefficient with the actual one, we assess what would have been the path of wealth inequality had the QE did not take place. The evidence of our analysis helps raising awareness of central bankers about the redistributive effects of their monetary policy decisions.

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- **Marica Frangakis**

"The European leveraged loans market – Developments, Risks and Policy Implications"

The latest global financial crisis gave rise to widespread concerns about the implications of continuing financial growth for financial and economic stability. These concerns were especially prevalent in the EU, where 'integration' was the buzzword in the 1990s and up to the outbreak of the crisis in the late 2000s. The European pursuit of financial deregulation prior to the crisis was at the expense of stability, as it was openly admitted by Trichet, then chairman of the ECB.

In the aftermath of the crisis, the financial regulatory framework has been tightened. However, this has led to new developments while a new generation of distortions seems imminent. In particular, the combination of the legacy of the crisis, the revised regulatory framework and technological developments, especially digitilisation, have given rise to a new generation of financial instruments – leveraged loans - which are reliant on market-based finance. Such instruments pose problems largely associated with shadow banking.

In the proposed presentation we shall discuss the evolving structure of the European financial system and its implications for policy. Our emphasis is on the leveraged loans and collateralized loan obligations markets in the EU, their linkages with shadow banking, the ECB regulatory system in place and the new risks emerging on the horizon.

- **John Grahl**

"The Coming Dollarisation of the Eurozone"

1. **Can the notion of dollarization be applied to a case of illiquidity and deflationary pressure and not just to cases of hyper-inflation?**

We can invoke Aglietta and Orléan on the breakdown of monetary systems. A rapid move to a new monetary object seems more likely following an inflationary crisis because that tends to be a centralising process, facilitating a general move from the discredited money, and one dominated by debtors who will be advantaged by the elimination of their old currency liabilities. A deflationary crisis is decentralising, attenuating or destroying old economic relations, and one dominated by creditors who might stand to lose if old currency claims were wiped out. In the classic case of deflationary breakdown, the general departure from the gold standard in the 1930s, there was no common move to an alternative until Bretton Woods. Nevertheless, the salience of the dollar as an alternative and the unresolved deflationary pressures arising from the workings of the eurozone may make dollarization plausible – in the form of a slow erosion of certain monetary functions. Nor would the process be unified – one might expect the turn to the dollar to be earlier and more complete in the weaker eurozone economies than in Germany

2. Indirect European integration – via Americanisation – would be nothing new

There is firstly the enormous role played by the US in the birth of the integration project. There are many subsequent examples. After the dissolution of the EPU (insisted on by Britain) in 1959, monetary integration was, until 1971, a consequence of the Bretton Woods exchange rate regime: the franc was tied to the D-mark because both were tied to the dollar. De Gaulle's bid for monetary independence collapsed with the *événements* of 1969.

Similarly, the irony of the pursuit of the "European Company" was clear to many commentators. The corporations which moved most fluently across the EC's internal borders and were least tied to particular locations were in fact American multinationals.

"The villainy you teach me I will execute and it shall go hard but I will better the instruction." US financial practices, often imperfectly understood by their European imitators, had enormous impact on both private and public actors in the EU. Consider the breath-taking leverage ratios achieved by eurozone banks in the subprime/securitisation bubble, which easily surpassed those of their US counterparts. Again, just when the shareholder value drive was meeting some determined judicial and legislative resistance in the US, the European Commission went all out for a takeover directive which would have abolished any effective defence against hostile takeovers.

3. The eurozone's rejection of external objectives weakens its internal policies

The external use of the euro is carefully monitored by the ECB which insists, however, that it has no external policy objectives. This is a damaging abdication weakening Europe's potential influence on the evolution of global financial institutions and practices; it has also led to a weakening of internal monetary policy. The absence of an active policy reflects, as do so many of the dysfunctional aspects of the monetary union, the parochialism of the German authorities, now reinforced by the equal commitment to Biedermeier styles in the so-called Hanseatic League. The ECB's 2017 report on the international use of the euro put a figure of 5% on the loss of efficacy of monetary policy instruments due to the growing interpenetration of US and eurozone financial systems.

It is worrying that the ECB suggests that this loss is compensated by moves in the $-€ exchange rate induced by its interest rate moves. Countries which implement monetary policies essentially by targeting their $ exchange rates are already in a clearly subordinate position: there is no "trilemma" for them – their open capital accounts eliminate monetary independence because they can never treat their exchange rates as a matter of indifference. On the contrary, regardless of the formal nature of the policy – float, crawling peg, or whatever – they have to set interest rates in function of FX pressures; Turkey as a recent case in point.

4. Much of the world is already partially dollarized. The US will not be much constrained by capital outflows to countries which make substantial use of the dollar – there is no real threat to convert dollar balances to rival stores of value

This impunity is an effect of *scale*: the more countries there are in such a position the weaker the external constraint on US finance and US macro policies. We have been waiting a life-time for these chickens to come home to roost but, as with the sterling balances of the British Empire, the very possession of hegemony leads to its reinforcement. Ito and McCauley (2018): ""This study divides the world into currency zones according to the co-movement of each currency with the key currencies. The dollar zone groups economies that produce well over half of global GDP…..Global imbalances differ from a currency perspective. In the 2000s, the dollar zone's current account disappeared by the onset of the Global Financial Crisis (GFC), even as the US current account plumbed all-time lows."

5. **We observe ongoing dollarization in two key areas: collateral and funding**

The first of these relates to the German government's petty bourgeois views on credit. Borrowing is bad and so there should be a law against it – preferably one with constitutional force. Germany itself will cling to the *Schuldenbremse*; misbehaving governments in the Club Med will have to pay a risk premium on their bonds, even though this declared risk complicates their use as collateral and renders the pricing of other securities more difficult. (The ECB currently holds so much eurozone debt that it strains credulity to suggest that bond yield differentials are simply a matter of market forces. The ECB has become the market.) Every proposal for bond issuance at European level is blocked by the German and like-minded governments.

- ## Stefanos Ioannou

"Current state of affairs in European banking: A critical assessment"

The aim of this presentation is to critically assess the current state of affairs in European banking. There are three aspects I aim to highlight, all of which are in tangency with one another. First, I analyse the evolution in the size of European megabanks since the crisis of 2007/08, and the change in their scope, activities and exposures. Second, I discuss the responses of European banking regulation to the post-crisis financial landscape. What have been the advocated reforms, and how have these materialised into concrete action so far? Third, I pay attention into the role of the European bank lobbying in not only affecting indirectly, but even participating actively in the writing of banking reforms in recent years. Overall, my analysis suggests that while some European megabanks have shrunk in size to some extent, the broader regulatory framework of European banking has fallen short from recording any substantial change. Such failed regulatory attempts reflect not just the flawed economic thinking of regulators, but also the persistence of the political power of megabanks in post-crisis Europe.

- ## Konstantinos Loizos

"Alternative policy choices related to NPLs: Is there a theoretical perspective?"

Non-Performing Loans (NPLs) have been an enduring problem in crisis-hit economies. This is more so in Greece which is suffering from an almost decade-long economic recession and severe fiscal consolidation. There is a large literature on the factors affecting NPLs and the possible solutions given the accumulated experience of financial crises during the deregulation era. However, not much has been said about the theoretical foundations of these solutions or how different schools of thought interpret the factors that generated NPLs in the first place. In addition, despite hints about country-specificity in the literature, there is no clear consideration of the elements of historical and institutional specificity, to the degree that any possible effort for resolving the NPLs problem might be conditioned by the latter. This paper aims at stressing the importance of these issues in defining and implementing a policy that would resolve the NPLs' problem in a way which is conducive to economic development given the institutional features of a particular economy.

- **Emilia Marsellou (with Yiannis Bassiakos)**

"Socioeconomic characteristics of the Greek bankrupt households: Evidence from the first years of implementation of the personal insolvency law"

This paper presents the socioeconomic profile of the Greek bankrupt households using court data from the judicial decisions of the first two years of implementation of the personal Insolvency Law 3869/2010. Income and/or job loss, family breakup, and women with children are important characteristics related to bankruptcy. It is also found that although the median of the household disposable income of the bankrupt households is lower than that of the households without financial difficulties, the former do not fall below the poverty line at a greater rate than the latter, in all household size instances.

- **Jan Toporowski**

"Non-Performing Loans over the Business Cycle"

Non-performing loans (NPLs) are treated in the banking literature as the result of 'risky' asset portfolio *c*hoices, with implications for 'prompt corrective action' or resolution. In fact NPLs are endogenous to the business cycle in two ways: First of all because the business cycle affects gross incomes in the economy. But secondly too because the business cycle affects the liquidity of the financial system, and hence the amount of credit in financial circulation that may be used for debt servicing. This reinforces the importance of central bank open market operations and commercial banks' credit policy in dealing with NPLs.