



Europe's Struggle to Recover and Reform

Nicolas Véron says that while Europe was faster to address the economic downturn, the United States has gone further in proposing banking reforms.

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Steve Weisman: Like the United States, Europe is struggling to get out from under the economic crisis and downturn of the last two years. This is Steve Weisman at the Peterson Institute for International Economics with Nicolas Véron, visiting fellow at the Institute and senior fellow at Bruegel in Brussels. Nicolas is here to discuss the comparison of the experience of the United States and Europe. Thank you for joining us, Nicolas.

Nicolas Véron: Thank you.

Steve Weisman: How has Europe fared in its recovery and how have the governments and Central Bank in Europe done compared to the United States?

Nicolas Véron: Of course, it's still a work in progress and it's difficult to draw a line. And a lot of the challenges are still ahead, so it's difficult to judge policies so far. Let me just mention a couple of failures and successes of the Europeans in this sequence of events.

I'll start with the failures because the European Union has gotten a lot of negative coverage through the crisis and there have been constant reminders of the dangers to the resilience of the euro area and the helplessness of Europeans all shooting in different directions. So this has been well commented. The Europeans have not been able to coordinate at some critical phases of the crisis. There have been tensions in the directions of economic nationalism and [of] a country trying to prop up its own banks, at the expense of others especially, through state aid.

Steve Weisman: And its own industries.

Nicolas Véron: And its own industries as well, especially the auto industry, which has come under a lot of focus. And clearly, [it's] a fiscal challenge, especially in the euro area countries. We have a single currency spanning 16 countries, and some of them are under heavy fiscal pressure at this point. Greece comes to mind, also Spain, Italy, possibly others. So there's this question of how the euro will withstand any critical developments in this area. But I think it's also important to mention the successes of the European Union or European policymakers through the crisis, and let me just briefly mention a few.

The European Central Bank, which is a young institution—it started in 1998—it was its first real test. I think it's fair to say that it passed the test quite well. Actually, the ECB [European Central Bank] was the first to react to the liquidity squeeze in early August 2007, even before the Fed did. So it was more decisive and bolder in its reaction than many people—including myself, to be honest—would have expected.

Another success in institutional terms is the one of the European Commission in its competition policy capacity. I mentioned all the pressures of economic nationalism and beggar-thy-neighbor policies. The European Commission has played a key role to make sure that these state aid measures to prop up domestic players wouldn't go too far, and it has actually had impact. It has obtained reversals of some policy decisions made by some member states in order to safeguard the integrity of those in the EU internal market.

Steve Weisman Which member states?

Nicolas Véron: Well, take for example—you mentioned the auto industry—take the example of the sale of Opel by General Motors. The German government had favored a consortium, which was backed by a Russian bank and with a Canadian auto parts maker—Magna—to take over Opel with some commitments by this consortium, basically to safeguard the German jobs at the expense of other jobs in other countries of the European Union. And the European Commission—the Competition Director General, which is a European equivalent to a combination of the Federal Trade Commission and the Department of Justice in the United States (they're the ones in charge of competition policies)—stepped in and they said, “Well, you cannot do that and you cannot give more favorable treatment to this offer compared to other offers that would maybe shed jobs in other parts of Europe or more in Germany.” As a result, the German government had to make a commitment that all offers or all possibilities for the future of Opel would be treated fairly and equally. This had an impact on the deal because actually, the deal didn't go through. General Motors decided not to sell Opel because, in principle, it had been granted by the German government the same sort of financial aid as was going to go to Magna and the Russians. So this is a very clear example of the European Commission imposing a level playing field and fairness of treatment.

Steve Weisman: What was the political reaction in Germany? And I want to segue from there into the political climate in the wake of a lot of the bailout measures.

Nicolas Véron: Right. This was particularly interesting because it was in the middle of a general election campaign in Germany. There was a lot of heat in the issue and also some division in the political class, including in the majority, which actually won the election. So let me say just that Mrs. Merkel, the German chancellor, was very upset by the European Commission. It didn't prevent her from winning the election, but it also didn't prevent the European Commission from doing its job, which to me is a remarkable illustration of the resilience of the EU institution framework, in spite of all the tensions, which had been exacerbated by the crisis.

Steve Weisman: In the United States, there is almost like a buyer's remorse on a lot of the initiatives taken by the Fed and the Congress and the Federal government, in terms of the bailouts, the money injected—especially the stimulus program—that's contributed to a kind of political counterreaction. Now, we're headed toward legislation to keep the banks from growing larger and maybe even making them smaller. What has been the reaction in Europe to all these bailouts?

Nicolas Véron: The political debates in Europe are predominantly national. So there is not such a thing as a European political discussion on this sort of issue, and therefore you have to make distinctions between each and every country. It seems to me that the political dynamic of this is very different [among] the three largest economies in Europe—United Kingdom, Germany, and France. In the United Kingdom you have had a backlash against bankers, which is not entirely unlike what you've had in the United States but which is different by

two measures. One is that the city of London is such a big part of the UK economy, much bigger than Wall Street is for the United States—

Steve Weisman: As a proportion of the British economy?

Nicolas Véron: Yes. I mean, London has the specialization in finance to an extent that the United States doesn't have because finance is just one of many sectors [that] are big in the United States. You have big oil, big pharma, auto industry, whatever, the entertainment industry. All these industries exist in the United Kingdom, but the importance of the city of London proportionally is extremely high. And also the United Kingdom had invested a lot in the specialization and in being a leader in the city of London, including by granting some tax privileges, for example for rich people who work there and earn a lot of money there, which have no equivalent in the United States. There's a specific factor here. I think the other factor in the United Kingdom has been the relationship to Europe and the fact that there is constant difficulty about the integration of the United Kingdom in the European Union, which has colored the political debate because Euroskepticism is a big issue there. Yet another important factor, which is especially important now, is that the UK government is a shareholder of the banking system to an extent. That is not the case in the United States. The United States has a minority stake in Citi, and it has injected and kept that in some other banks, but most of them have reimbursed now. With the United Kingdom, it's different. The United Kingdom is the majority shareholder in the Royal Bank of Scotland. It does control large banking groups. So the two main domestic banks are effectively under government ownership. The state's involvement in the banking system has gone much further even than has been the case in the United States.

Steve Weisman: Britain has had more of a socialist tradition since World War II. Is there the kind of [negative] reaction in the British population to the actions taken by the government? And then let's move to France and Germany.

Nicolas Véron: Well, the interesting thing is that the elites, at least in Britain—government and business elites and media elites—had thought that they had moved away from the socialist tradition through the Thatcher and Blair and Brown years. So there was this representation that Britain was really an open antistate economy in a way. So there's a lot of denial right now. You go to London and you have a lot of people in the elites who tell you, "Well, we haven't nationalized the banks. It's not really nationalization. You haven't understood what happened." That's quite remarkable. But I think you're right. I think the political reaction is different from the United States because of this longer-standing flow of political orientation that goes back to the postwar years, and which means that actually the nationalization is less disruptive politically in the United Kingdom than it would be or than it had been in the United States.

In Germany, the situation is extremely different because the German banking system is so peculiar. The German banking system—people think of Deutsche Bank when they think of German banks, but that's actually a misnomer. Most of the German banking system is made of unlisted companies, which are almost purely domestic in terms of their footprint, at least as to where the people live, and which is extremely interdependent with the German political system. That means that you have the states in Germany—you know it's a federal republic just as the United States—so the states own banks there. They in part own the savings banks. They are shareholders in a very big way, in a very significant part of the banking system. Local politicians sit on bank boards. So [there is] this intrameshing of

the political establishment especially at the local level, less so at the Federal level. And the local banks, which form the backbone of the German banking system, [are] an enormous determinant of what has been so far, unfortunately, German reluctance or outright inability to tackle the losses in the banking system because it's so embarrassing for the politicians [who] are directly involved in it.

Steve Weisman: We saw some of that during the savings and loan crisis in the United States when those institutions were tied with local political authorities.

Nicolas Véron: Exactly. It's very similar. It's much more similar in political terms to the savings and loan crisis than it is to this crisis in the United States and Germany. And therefore in Germany, basically, there has been no move so far to really bring transparency to the losses in the system, restructure the banks, which are effectively bankrupt, and so [there is] a different sort of denial, if you will.

Steve Weisman: And this poses a danger to the future of recovery and sustainability?

Nicolas Véron: Not only in Germany but actually in the whole of Europe because Germany has this sort of very insular banking system, but its economy is central to Europe. So the inability of public authorities to tackle the problems in banking creates, I think, a drag very similar, for example, to what happened in Japan during the 1990s. That is bad news—not only for Germany. It's bad news for the whole of Europe.

Steve Weisman: There's a lot of criticism that the United States has not moved aggressively enough against the major banks. Maybe 100 or a couple of hundred of the smaller banks have been dissolved out of 8,000 banks in the United States. Has the United States or Europe been more clear-eyed in addressing their failures of the banking system?

Nicolas Véron: Well, I don't think the two regions—the United States and Europe—have the same problems. The crisis clearly started in the United States and expanded to Europe because of major risk management failures in Europe. So it's not a total symmetry now. I think on the whole, the United States has done better. The United States has taken significant actions through the stress testing, which I think had very significant market impact in the spring of last year. This was crucial because it told the marketplace basically, more or less, who was strong—who was weak in the banking system. You had this so-called triage effect, which was very important to restore a degree of trust in the marketplace about the banking system. We haven't had that in Europe.

Also in terms of regulatory reform, I think we're seeing now, probably, more readiness to explore the whole range of solutions in the United States. Of course, decisions are still sometimes off, and I'm not expecting any end to the regulatory debate in the next few weeks. But I think the announcement about the Volcker rule or the levy on banks go farther in terms of broadening the range of possible options [than] what I've seen in the European Union, with some exceptions in Britain, which probably has been more innovative in their space than as a continental. So I would say, both in terms of tackling the immediate crisis, fixing the banking system, and exploring regulations to make sure this doesn't happen the same way in a few years' time, I would certainly not say the United States has been satisfactory in its response and there is plenty of appropriate criticism

to be put on the authorities' reaction. But if I compare, I think they (the United States) have done better on the whole. Of course, Europe has pressing problems that the United States doesn't have to the same extent, which [are] cross-border linkages. And actually, the European attention has as a priority to propose some cross-border supervisory mechanisms and something like that. So I think in fairness, Europe has additional problems linked to the fact that it's actually 27 sovereign economies that the United States doesn't have and that perhaps helps get them a more balanced view.

Steve Weisman: Nicolas Véron, we could go on but we want to keep these limited. But maybe you could come back soon and discuss the same subject. Thank you very much for joining us.

Nicolas Véron: Thank you.

