

*Shaping the Fiscal Institutions of Europe*  
*Berlin, November 2012*

# Insurance and Incentives in a Monetary Union

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NYU-Stern

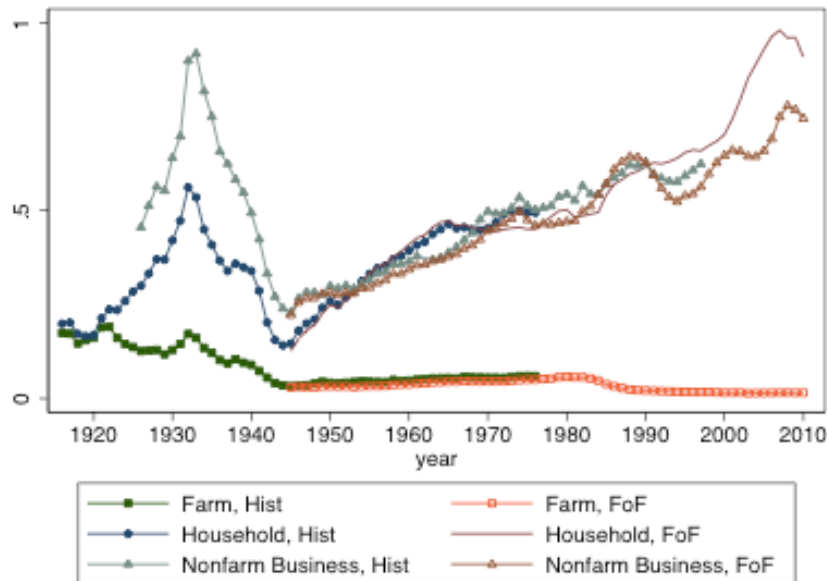
NBER, CEPR

# The End of a Long Cycle

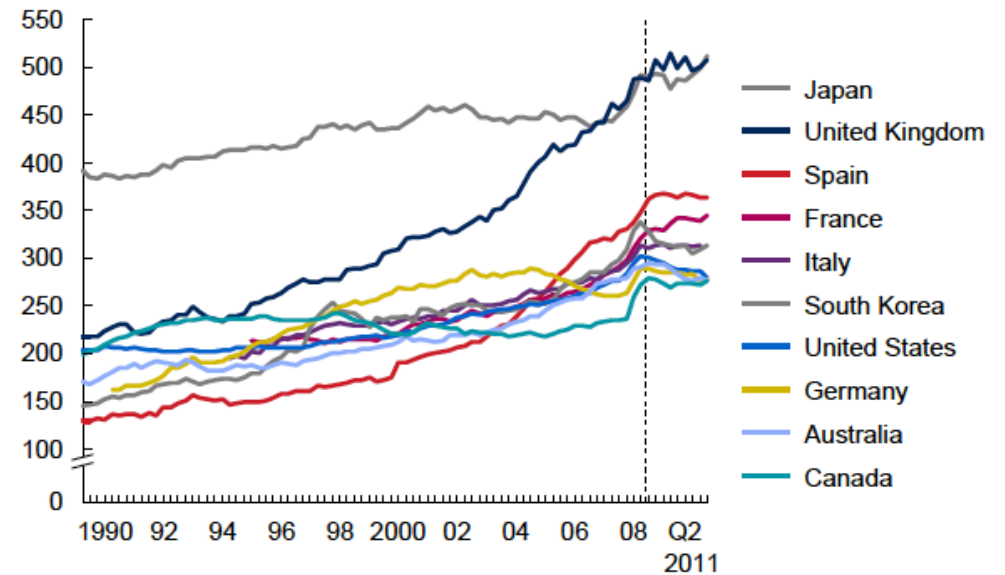
US Public Debt/GDP



US Private Debts



Total Debts



Sources: Philippon 2012, McKinsey, 2012

# Heterogeneity and Deleveraging

## Household debt levels vary significantly across US states

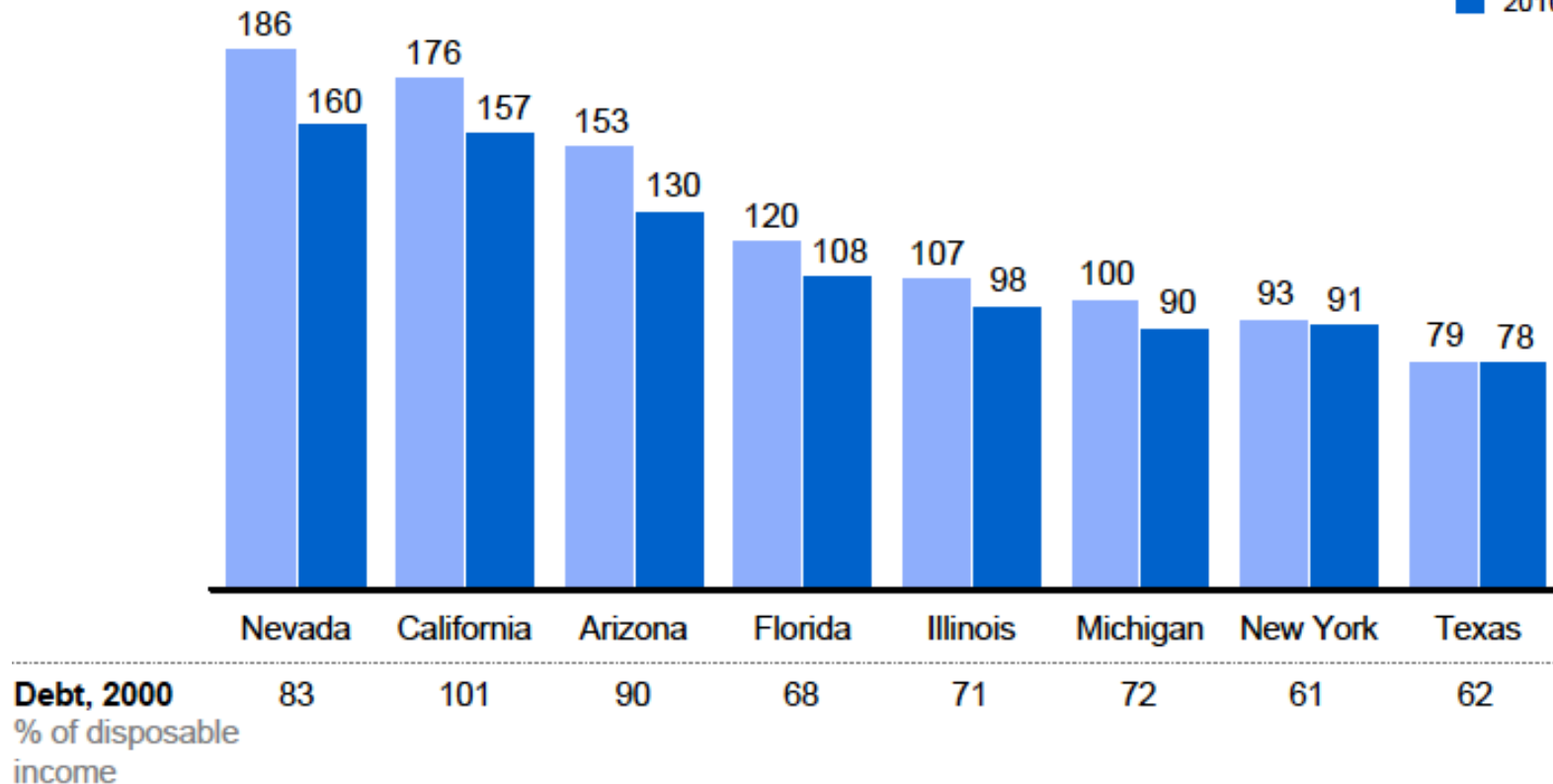
Household debt<sup>1</sup>

% of disposable income, annual average



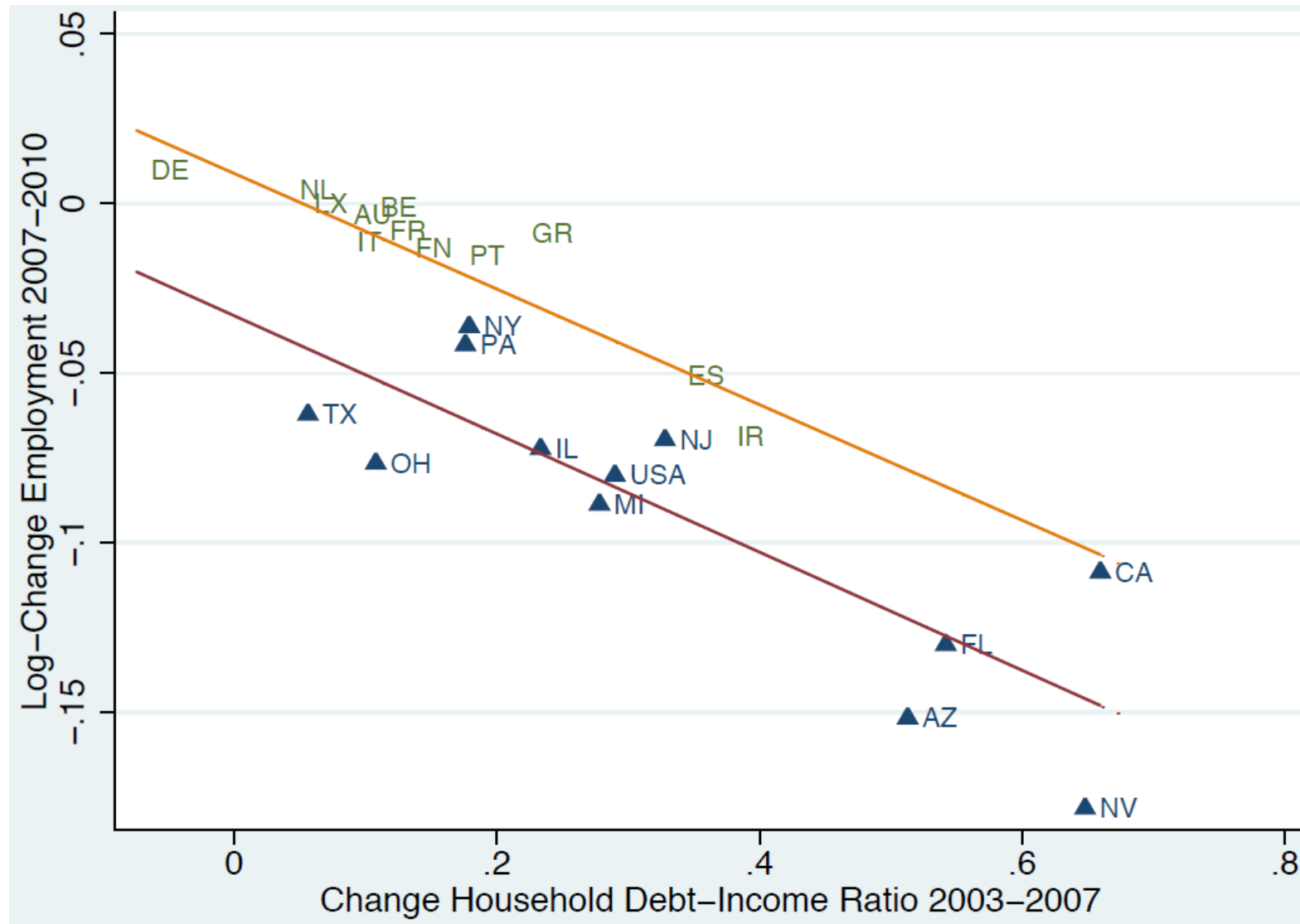
2008

2010



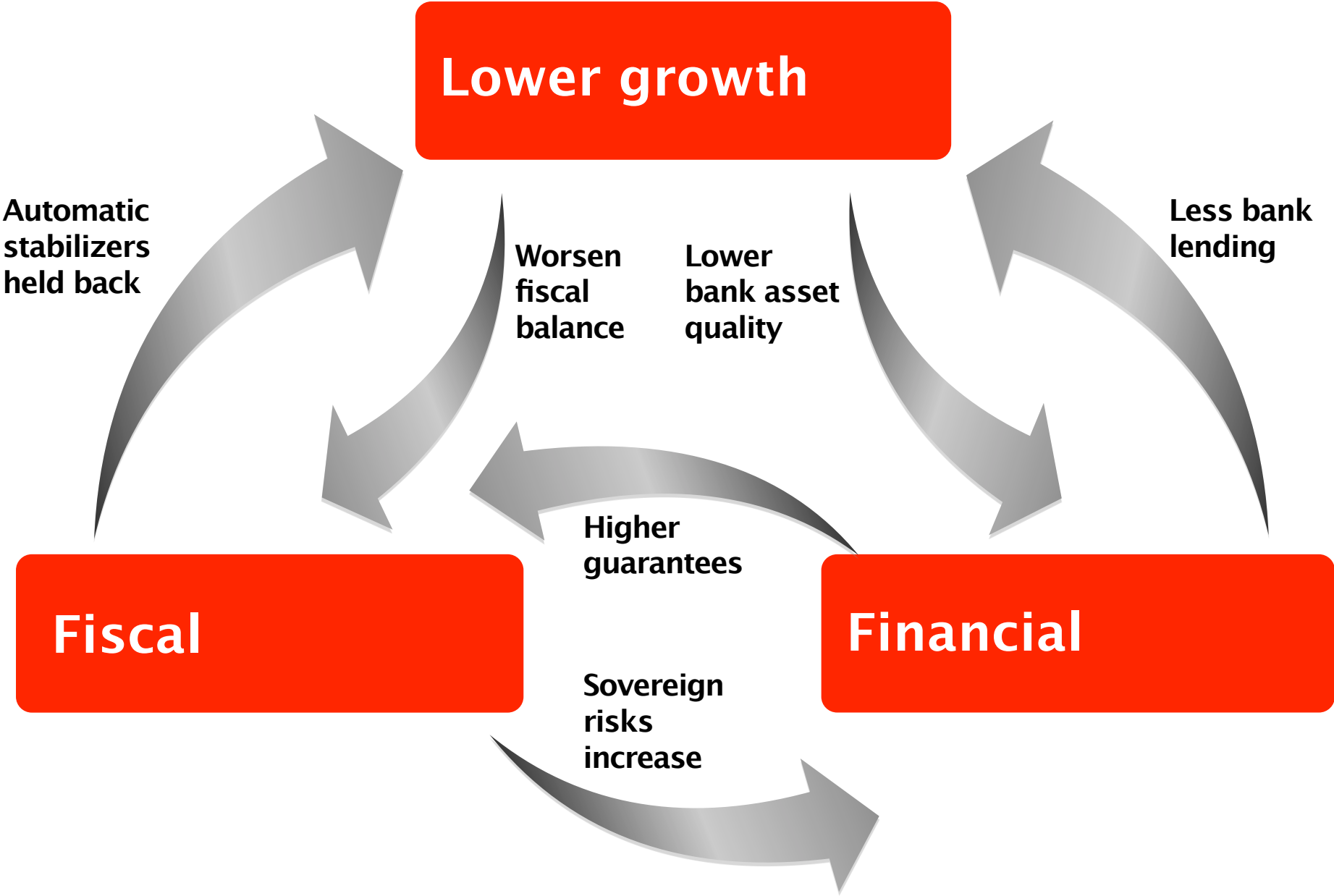
Source: McKinsey, 2012

# Leverage & Recession 2007-2010



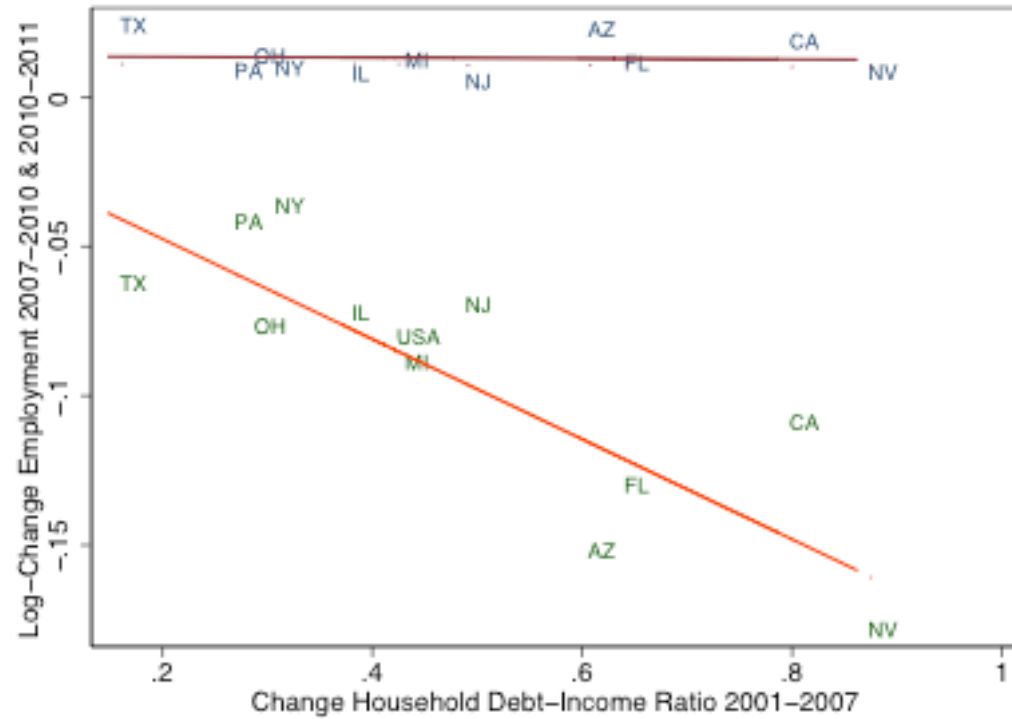
Sources: Philippon 2012

# Deleveraging Risks

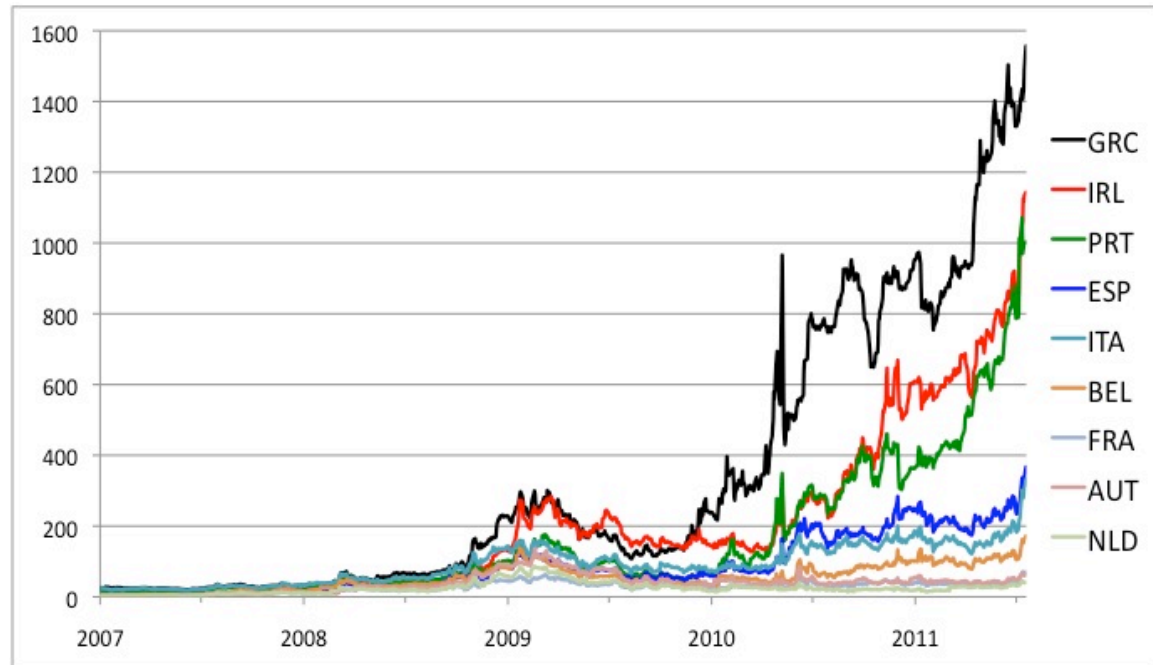


# Stage 2 of the Crisis 2010-2012

US



EU  
Spreads Over 10-Year  
Bunds (Basis Points)



Sources: Philippon 2012

How to Make EZ  
a Stable Currency Area?  
Insurance *and* Incentives

# Banking Union

- The single currency is really single only if the banking system is also single
- US
  - Bank of America is based in Charlotte, North Carolina
    - BoA Assets = \$2T, NC GDP = \$425B, Ratio = 4.7
  - Wells-Fargo is based in California
- EZ
  - Insurance & Incentives = Supervision & Resolution



# Fiscal Integration

- Federal States typically have:
  - Balanced budget rules for local governments
  - No direct refinancing of local governments by the central bank
  - No bail out by the central government
- A large federal budget

| Degree of Centralization of Public Spending |      |       |
|---|------|-------|
|   | UE   | US    |
| Energie Policy                              | 4.2% | 100%  |
| R&D Policy                                  | 6.3% | 10.4% |
| Social Policy                               | 0.4% | 88.2% |

IMAGINE  
*John Lennon*



MUSIC FROM THE ORIGINAL MOTION PICTURE



# Unemployment Insurance Spending (% GDP)

|                | 2002       | 2003       | 2004       | 2005       | 2006       | 2007       | 2008       | 2009       | 2010       |
|----------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| Denmark        | 4,0        | 4,2        | 4,2        | 3,8        | 3,1        | 2,6        | 2,4        | 3,0        | 3,4        |
| <b>Germany</b> | <b>2,7</b> | <b>2,8</b> | <b>2,8</b> | <b>3,5</b> | <b>3,3</b> | <b>2,8</b> | <b>2,6</b> | <b>3,1</b> | <b>2,9</b> |
| Ireland        | 1,3        | 1,3        | 1,2        | 1,1        | 1,2        | 1,3        | 1,7        | 3,1        | 3,7        |
| Greece         | 0,8        | 0,7        | 0,8        | 0,8        | 0,7        | 0,8        | 0,7        | 1,0        | 0,8        |
| <b>Spain</b>   | <b>1,6</b> | <b>1,6</b> | <b>1,6</b> | <b>1,6</b> | <b>1,6</b> | <b>1,6</b> | <b>2,1</b> | <b>3,2</b> | <b>3,2</b> |
| France         | 1,9        | 2,1        | 2,1        | 2,0        | 1,7        | 1,6        | 1,5        | 1,8        | 1,9        |
| Italy          | 0,5        | 0,5        | 0,5        | 0,5        | 0,5        | 0,5        | 0,5        | 0,8        | 0,9        |
| Netherlands    | 1,8        | 2,1        | 2,1        | 2,0        | 1,8        | 1,5        | 1,3        | 1,9        | 2,0        |
| Finland        | 2,7        | 2,9        | 2,8        | 2,6        | 2,4        | 2,1        | 2,0        | 2,9        | 2,5        |
| UK             | 0,3        | 0,4        | 0,3        | 0,3        | 0,3        | 0,3        | 0,3        | 0,5        | 0,5        |
| Norway         | 0,7        | 0,9        | 0,8        | 0,6        | 0,4        | 0,3        | 0,2        | 0,4        | 0,5        |

# Average and Cycle

- Average UI Spending

- IRE: 1,77%
- FRA: 1,84%
- ESP: 2,01%
- GER: 2,77%

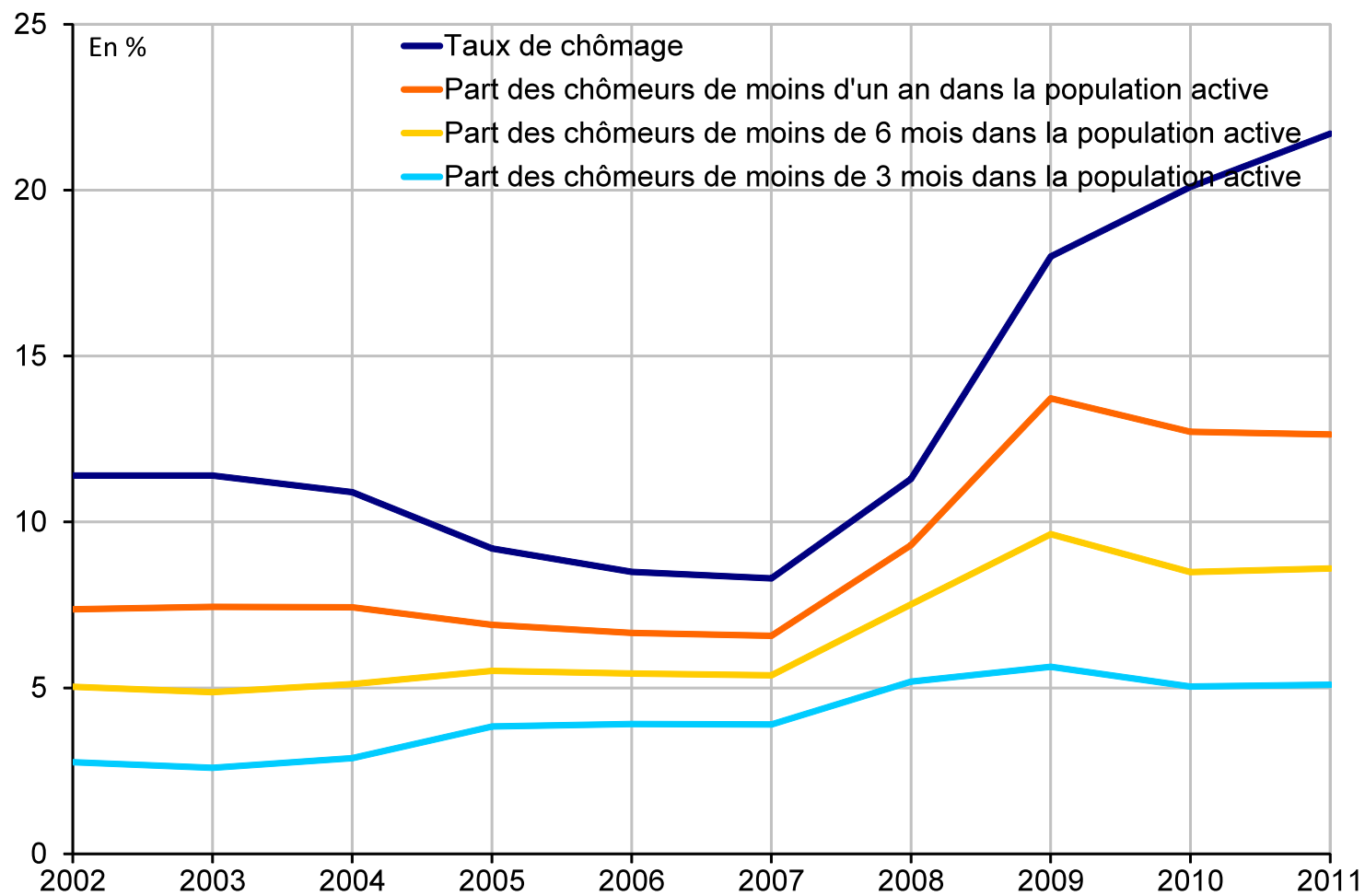
| Deviations | 2005  | 2010  |
|------------|-------|-------|
| Germany    | 0,56  | -0,04 |
| Irlande    | -0,67 | 1,93  |
| Espagne    | -0,41 | 1,19  |
| France     | 0,16  | 0,06  |

Insurance up to  
1.6% of GDP

Zero net transfers over 10 years

# How much to insure?

## Unemployment Rates in Spain



# Incentives

- Replay history
  - 2005: ESP → GER
  - 2012: GER → ESP
  - Smaller bubbles, smaller recessions
- Rules vs Discretion
  - Stigma
  - Credibility and acceptability
  - Commitment, on both sides
  - Denial
- A budget for the Eurozone

