

Regional public goods: Lessons for Asia and the Pacific from Europe

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Implications for Supporting Sustainable Development

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Motivation

- A number of European experiences with regional public goods (RPGs) can provide valuable insights for Asia and the Pacific
- Three sectors:
 1. Banking
 2. Energy
 3. Information and communications technology (ICT)
- Key questions of planned paper:
 - What is the nature of the RPGs in these sectors in Europe?
 - What mechanism is used to supply these goods?
 - How have the issues related to providing these goods been overcome?
- Applicability of the data, methodology, and results to the context of Asia and the Pacific will be evaluated, the core of the work will be on European context

RPGs and the European banking sector

A snapshot of the European banking system (end 2015)

Banking system	Total assets (billions)	Domestic assets (billions)	Activity abroad (%)	CR-5 Ratio (%)	Assets/GDP (largest, %)	Assets/GDP (top 3, %)	Assets/GDP (top 5, %)
China	€ 28,226	€ 26,999	4.3	40.4	30.1	76.9	113.6
Euro area	€ 27,747	€ 22,757	18.0	24.6	18.8	50.1	73.3
U.S.	€ 14,296	€ 13,044	8.8	40.4	10.7	28.7	38.3

Source: Bruegel based on SNL data and China Banking Regulatory Commission (CBRC) for China, ECB (2016a) for the euro area, and Federal Reserve for the United States. Notes: The total assets comprise consolidated assets of domestic banking groups and domestic assets of subsidiaries and branches of foreign banks. To calculate the size of the respective banking systems (labelled as domestic assets), the foreign assets of the domestic banks are deducted. The concentration ratio of the largest five banks (CR-5) is based on their domestic assets as a percentage of total domestic assets.

RPGs in the banking sector

- Since the crisis, there has been significant institutional and regulatory change in the EU banking sector
- The euro area in particular contains valuable examples of RPGs
- The crisis showed that financial stability is a fragile public good and cross-country spillover matter significantly
- This is especially true in integrated financial areas, where single monetary policy may not fit all countries, and has limited counteracting role
- Monetary union by itself creates a host of specific issues for financial stability.

RPGs in the banking sector

Before the crisis:

- Banking supervision was a national prerogative
- The strong link between banks and sovereigns created a vested interest for governments to bail out banks
- There was almost no macro-prudential oversight, implying that risk could easily spill over to other countries

Results:

- Divergent credit cycles
- Massive Home Bias
- Balance of Payment crisis
- Financial fragmentation and convertibility risk

The role of the ECB has changed

- Relative to national supervisors, a supra-national supervisor like the ECB may be also less prone to regulatory capture and better placed to:
 - Oversee the transnational dimension of domestic policy
 - Identify potential risks for the euro area
- Assigning more responsibility to the ECB can essentially be considered a key step to increased financial integration in the euro area as a whole
- Some macroprudential (on top of microprudential) supervision role
 - Spillover effects of macroprudential policy on credit and asset prices
 - A regionally integrated framework helps internalize these cross-border effects

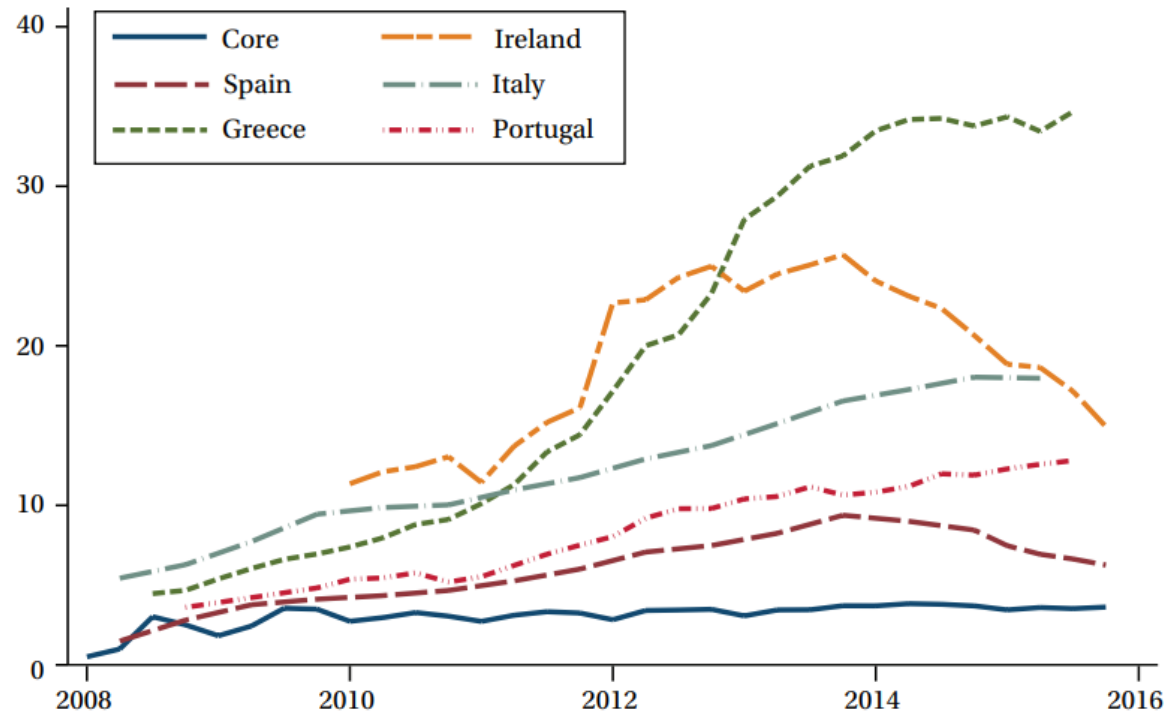
The regulatory context has radically changed

Since the crisis:

→ European Banking Union:

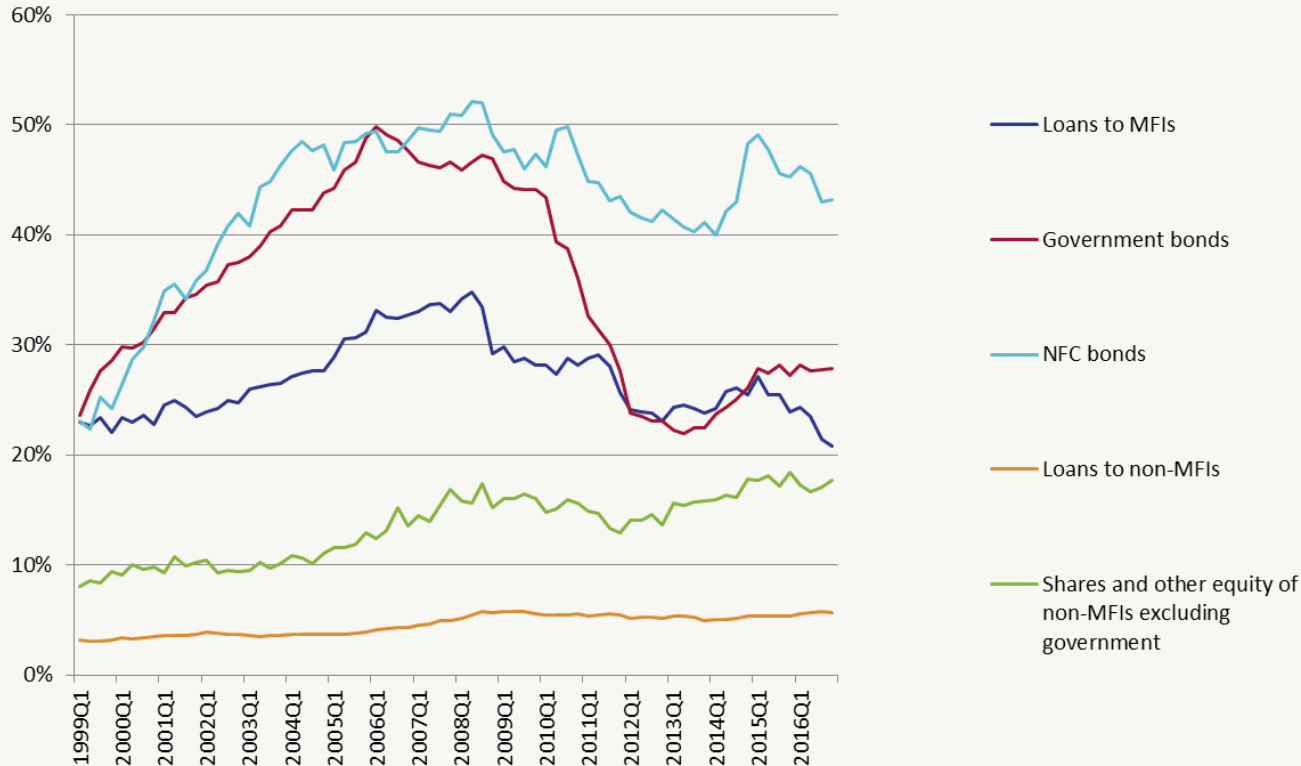
- Prevent risk *ex ante* through:
 - A single rulebook (common rules for EU banks) and
 - A single (supra-national) supervisor at the ECB
- Control risk *ex post* through:
 - Common rules to deal with banking crises (e.g., BRRD) and
 - A single resolution mechanism

Non-performing loans (% of total gross loans)



Source: Bruegel based on IMF Financial Soundness Indicators database. Note: 'Core' refers to a simple average of Austria, Belgium, France and the Netherlands (Germany is omitted for lack of data availability).

Financial integration in the euro area: Share of cross-border holdings of assets of euro area monetary financial institutions (MFIs)



Early signs of some positive effects of reforms, detecting/treating legacy issues in national banking sectors

Unfinished jobs:

- Capital Market Union
- Deposit insurance

The European experience bears important lessons for Asian countries which eye closer financial integration

It clearly suggests that financial integration can be a regional public good but it necessitate the right institutional framework function

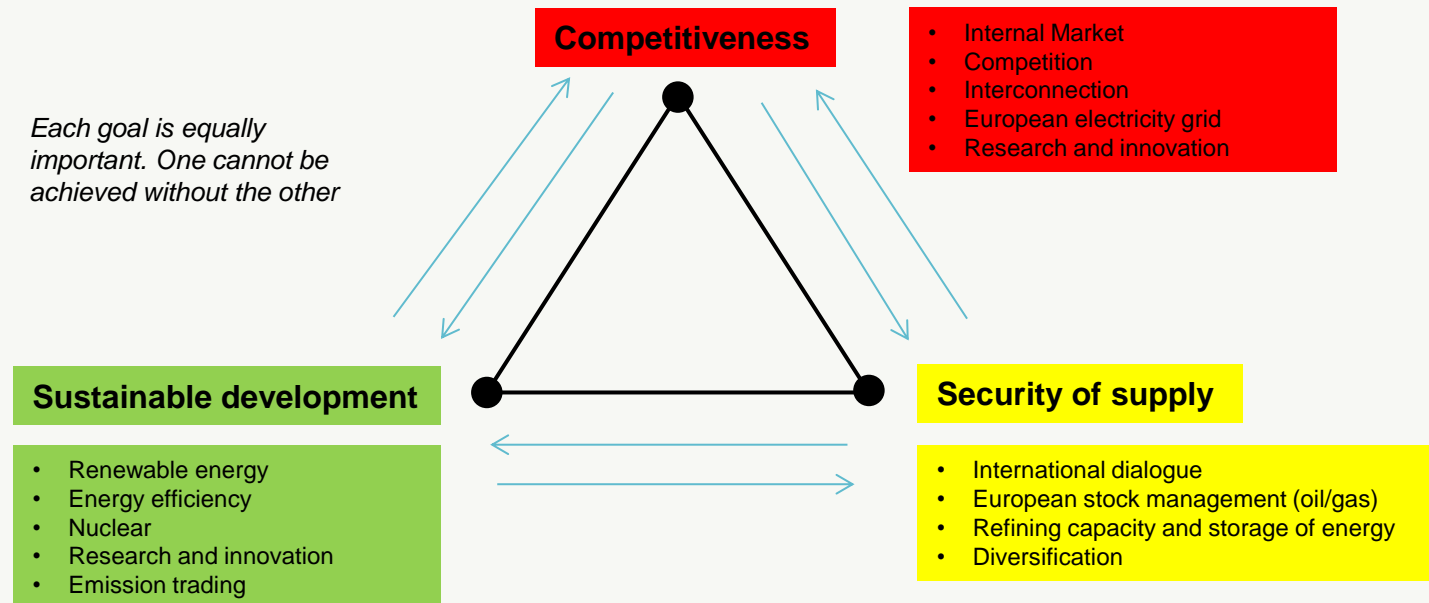
Source: Bruegel based on ECB

Note: The lines measure the share of intra-euro area cross-border holdings in total euro area holdings

RPGs and the European energy sector

Europe's energy sector

- Europe can provide important lessons for the coordination of:
 - Energy and climate policy
 - Environmental policy
- In terms of energy, EU Member States are progressively aligning their policies to achieve 3 targets:



Sustainable development RPG: better environment for all

- In 2009, the EU adopted the '20-20-20' energy and climate policy targets

GHG Emissions Reduction

20% compared to 1990

Binding via ETS

Increase of Renewables

20% of total energy consumption

Binding via RE Directive

Increase of Energy Efficiency

20% compared to baseline

Binding via EE Directive

- National level-binding targets strongly impacted the EU energy system.

In 2015:

- EU GHG emissions were down by 22% compared with 1990 levels
- EU consumed 10.7% less primary energy than in 2005
- Renewable energy provided 16.7% of energy consumed in the EU (9% in 2006)

Sustainable development

RPG: better environment for all

- The EU scaled-up its level of ambition in 2014 with new 2030 targets

GHG Emissions Reduction

40% compared to 1990

Binding via ETS

Increase of Renewables

27% of total energy consumption

Only binding at EU level

Increase of Energy Efficiency

27% compared to baseline scenario

Only binding at EU level

- The EU has also put in place environmental protection legislation
- Example: The Industrial Emissions Directive (IED)
 - EU instrument for regulating harmful industrial emissions across the union
 - Imposes stringent emissions requirements on industrial combustion plants
 - Restricts the number of running hours for plants unable to meet the emissions requirements

RPGs and Information and communications technology (ICTs) in Europe

RPGs and ICTs in Europe

Many affected parties, distinct issues to address

- ICT producing organisations
 - Network operators
 - Online service providers
 - Suppliers of ICT equipment
- ICT users
 - Industrial firms
 - Other businesses, including SMEs
 - Everyone!
- Distinct needs → Distinct policy instruments
- Example discussed: mobile roaming

Many issues → Many tools

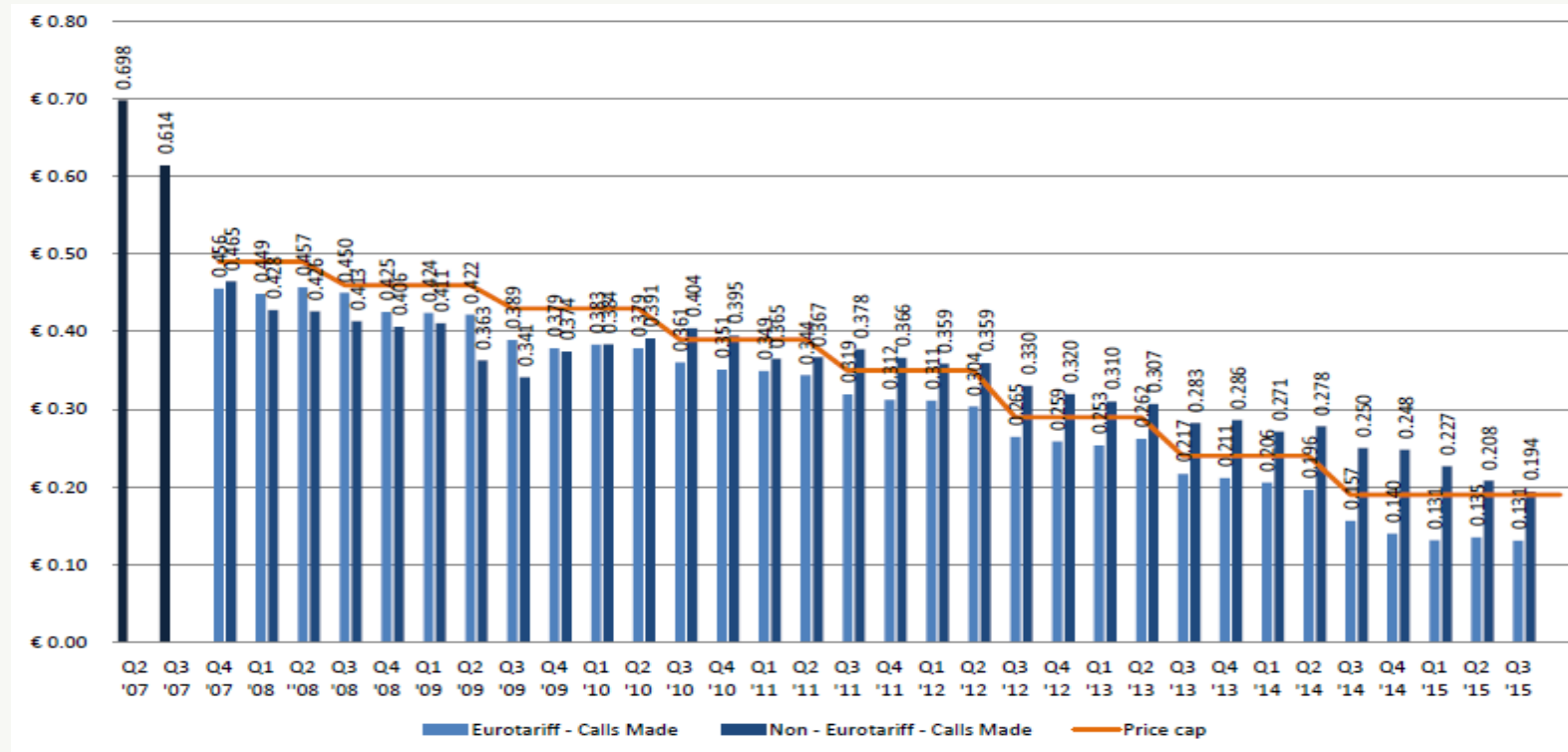
- Facilitating cross-border investment
 - Elimination of needless barriers to market entry: Regulation
 - Access to spectrum, rights of way, numbers: Regulation
 - Reduced complexity: Harmonised regulation across Member States
- Interoperable cross-border services
 - Standardisation
 - Interconnection: Regulation
 - Mitigation of anticompetitive barriers to interoperability: Competition law
- Avoidance of needless tariffs/duties for ICT products / services
 - Within Europe: Single Market
 - With third countries: Free Trade Agreements (FTAs), WTO rules

International mobile roaming in Europe

- International Mobile Roaming (IMR): A service whereby a user who subscribes to mobile telecommunications services in one country is able to use his or her mobile device in other countries.
- Absent regulation, roaming prices tend to greatly exceed real costs.
- The EU has imposed EU-wide rules since 2007.
 - The retail/wholesale price caps imposed in 2007 immediately reduced roaming prices by up to 70%.
 - Prices were gradually reduced in subsequent years, with positive impact.
 - Roam Like at Home (RLAH) took effect in 2017, probably with negative medium to long term impact.
- These price reductions increased net societal welfare.
- Lower consumer prices for roaming can also serve to strengthen regional cohesion and integration.
- Imposition of roaming rules would have been very difficult without an empowered EU.

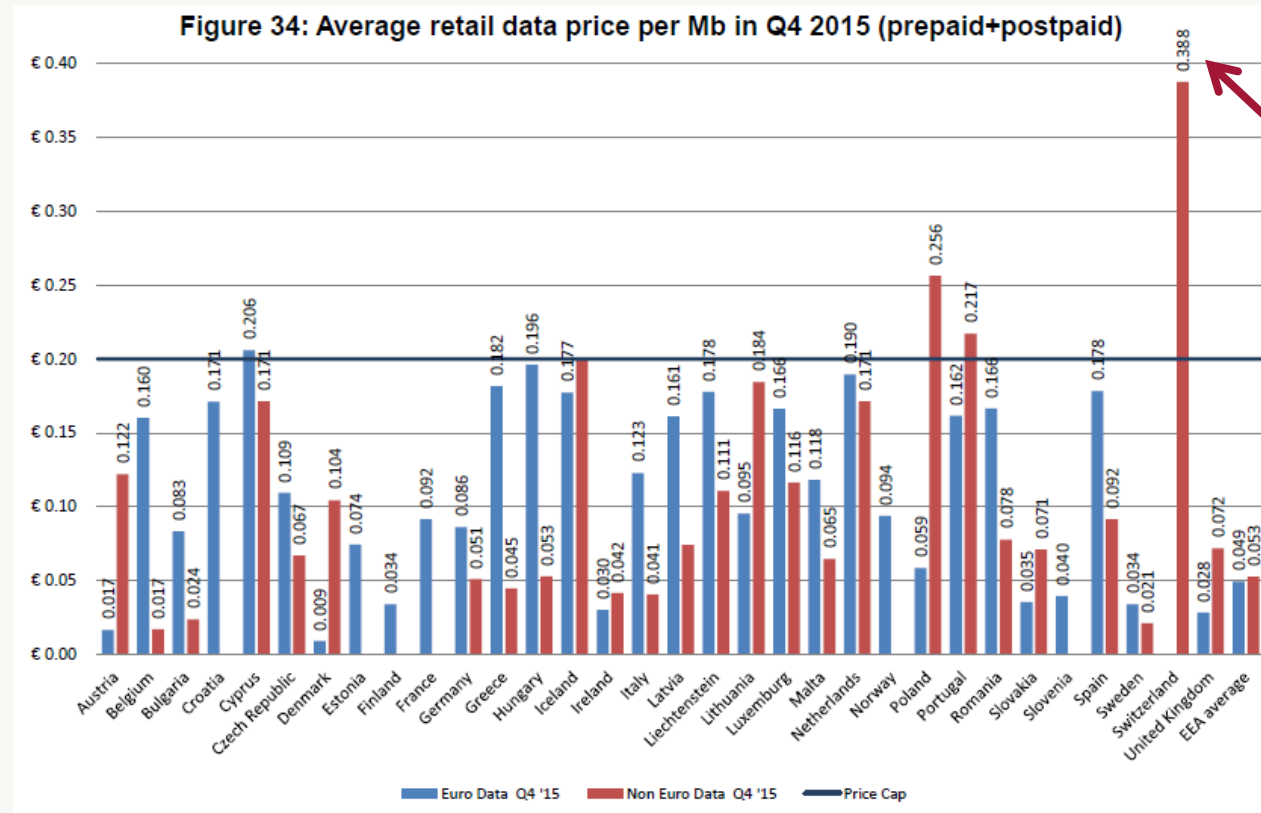
EU roaming rules have reduced consumer prices over the years

EEA average retail price per minute for intra-EEA roaming voice calls (in EUR)



Source: International Roaming: BEREC Benchmark Data Report: October 2015 – March 2016

Switzerland (non-EU) does not fully benefit from EU roaming rules



Retail price for roaming data in Switzerland

Conclusions

- European Union as a supra-national regional entities bears important lessons of how to foster regional public goods
- The provisioning of RPG is determined by political cohesiveness but in itself it also drives political cohesion.
- Three important areas: Financial integration, energy and environment, ICT
- In all three, EU-level policies have made a major and substantive difference to the provisioning and the quality of the RPG