DEEPENING OF THE ECONOMIC AND MONETARY UNION – EU AND US HISTORICAL PERSPECTIVES

Marco Buti

DG Economic and Financial affairs, European Commission

GLOBALISATION DYNAMICS - EU AND US PERSPECTIVES

SESSION 1: European Institutions: post-Brexit and 2017 elections - New York, 11 October 2017

OUTLINE

- 1. The Euro: a young but ambitious currency
- 2. Current state of play
- 3. Completing EMU: why and how?

MORE THAN A YEAR AFTER BREXIT

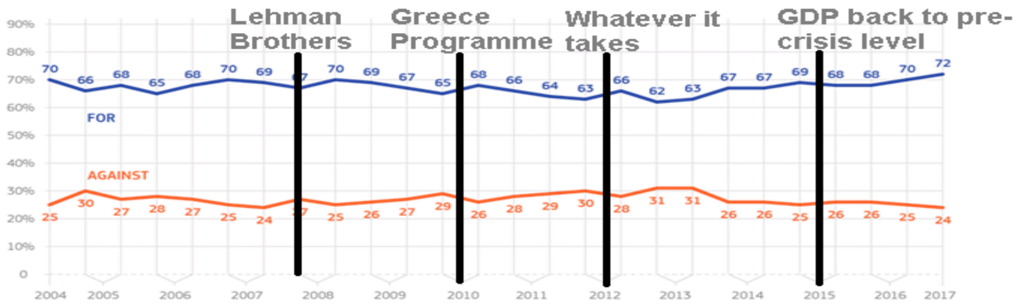
"We are going to make progress. We will keep moving. We will move on because Brexit isn't everything. It isn't the future of Europe."

Jean-Claude Juncker, State of the Union Address, 13 September 2017

European Commission

PERCEPTION OF THE EURO

- Tangible benefits for citizens, firms and governments
- The symbol of European integration
- While the crisis shook confidence, popular support for the euro has been consistently high



Source: European Commission and Eurobarometer 2017

European Commission

BREXIT AND THE EURO

- Following Brexit, the **euro area GDP will be 85% of the GDP of the European Union**.
- The perspective is for all Member States (except Denmark) to join the common currency.
- Brexit makes completing the Capital Markets Union more challenging, yet more important.
- Budget drop reinforces the focus on new European public goods

European Commission

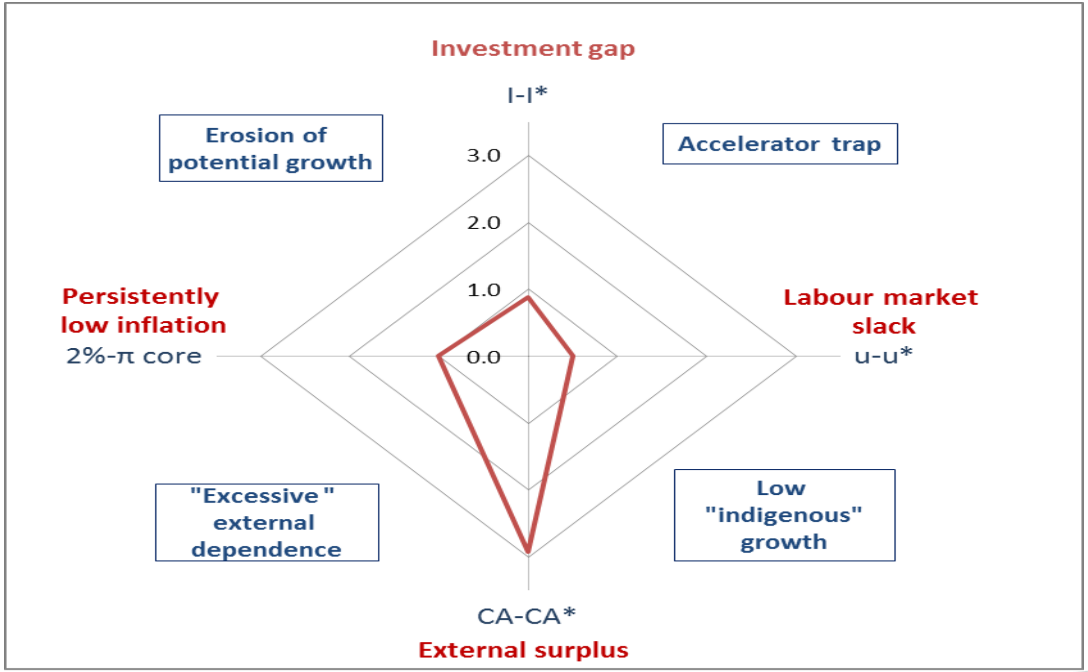
ELECTION CYCLE 2017: A WINDOW OF OPPORTUNITY

- Last year this time: economic recovery hampered by huge political uncertainty
- Populism in check: NL, AU, FR, ...and yes DE
- From depression to euphoria and back: wrong perception
- A more inward-looking Germany? I don't think so

OUTLINE

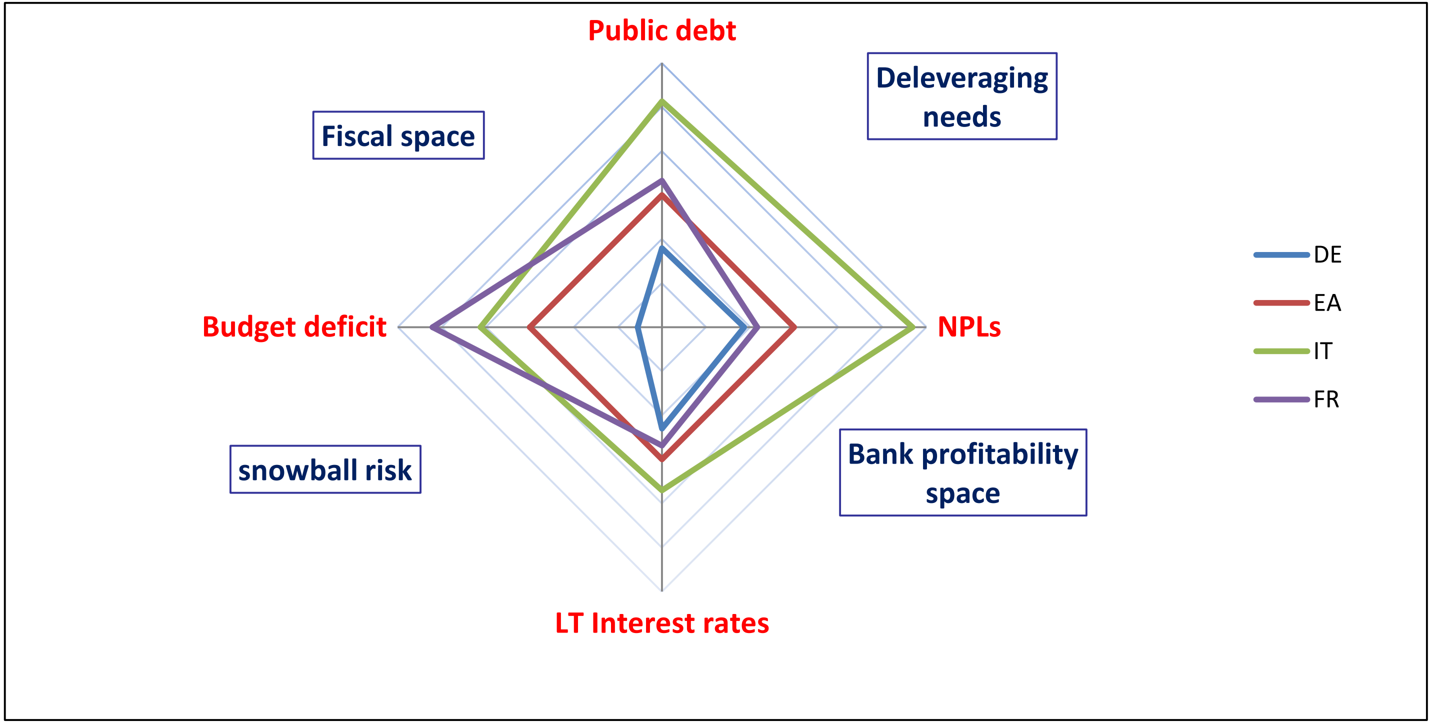
- 1. The Euro: a young but ambitious currency
- 2. Current state of play
- 3. Completing EMU: why and how?

STRONG RECOVERY, YET NOT COMPLETE



European Commission

CONDITIONS IN PLACE TO DEAL WITH FISCAL AND FINANCIAL FRAGILITIES



OUTLINE

- 1. The Euro: a young but ambitious currency
- 2. Current state of play
- 3. Completing EMU: why and how?

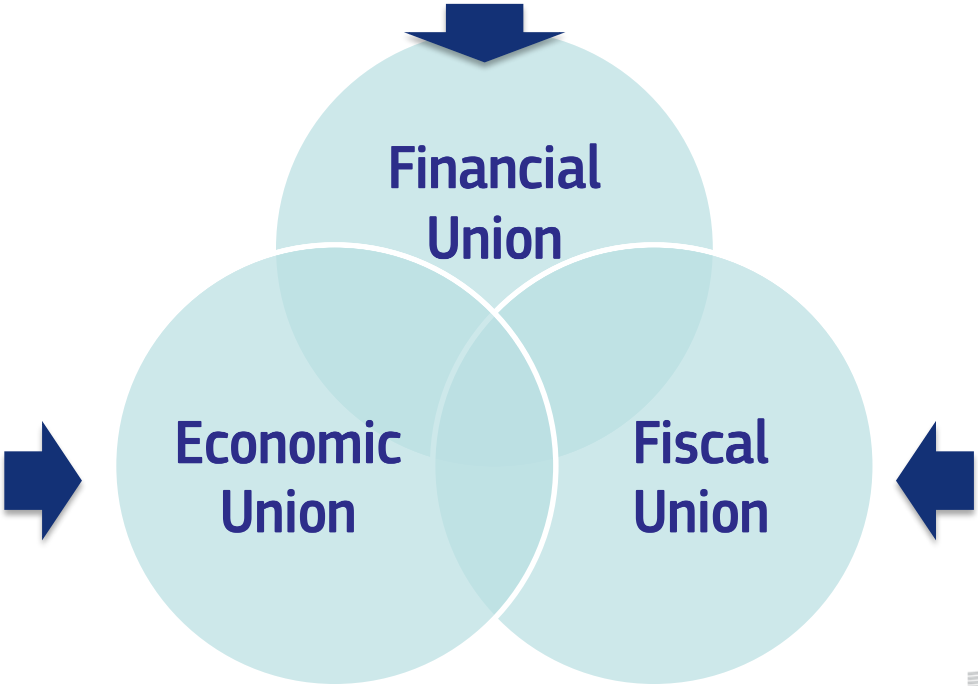
A DETERMINED RESPONSE TO THE CRISIS STABILISED THE SITUATION, BUT THE EMU INSTITUTIONAL SET-UP IS STILL INCOMPLETE

- Remaining sources of financial vulnerability and risk of renewed financial instability, especially given high public and private debt
- Insufficient collective stabilisation tools
- Impossible to achieve simultaneously:
  - an appropriate fiscal stance for the euro area as a whole
  - an optimal distribution of the fiscal effort
- Persisting economic and social divergences
- Complex governance and democratic deficit

European Commission

A NEW POLITICAL SYNTHESIS IS NEEDED

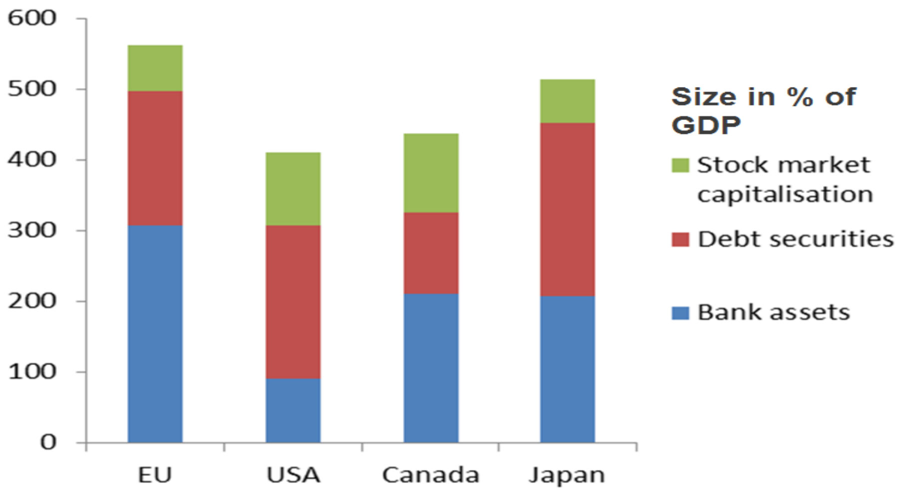
Risk Sharing and risk reduction



Reforms and incentives

Sound budgets and fiscal capacity

FINANCIAL UNION: INTERNATIONAL COMPARISON

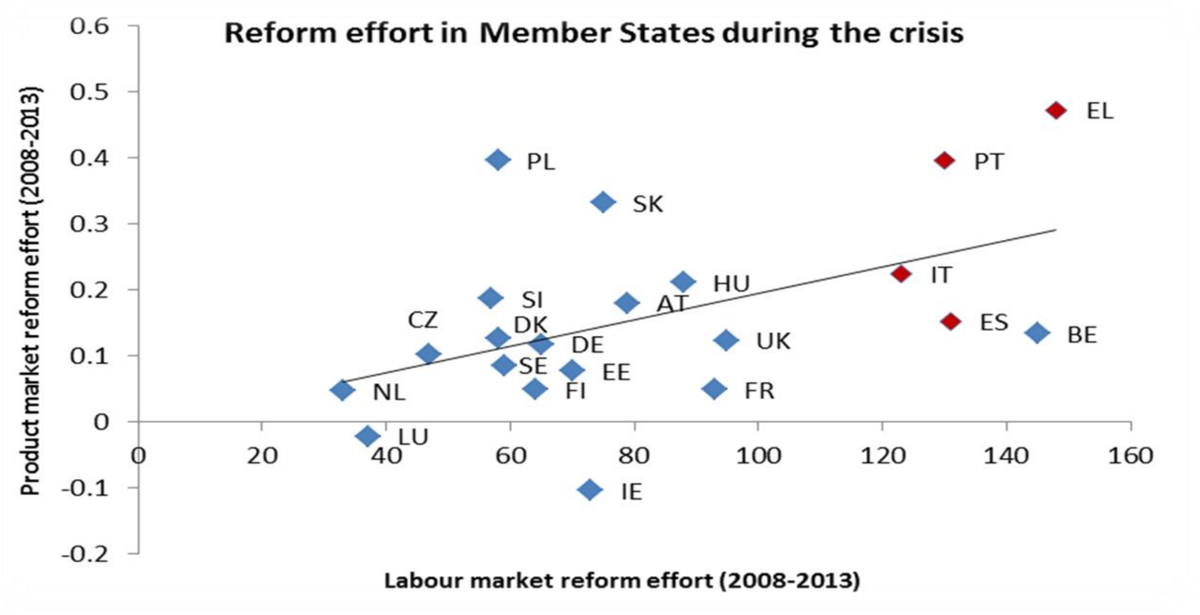


Source: IMF

FINANCIAL UNION: THE MOST URGENT PRIORITY FOR EMU

- Advancing on risk reduction and risk sharing and providing more diversified financing options for firms
- Short-term measures
  - Further reducing risks and building on banks' better capitalisation
  - Completing the three pillars of the Banking Union (BU)
  - Delivering on the Capital Markets Union (CMU)
  - Possible instruments beyond BU and CMU: Sovereign bond-backed securities
- Post-2019: possible additional successive measures
  - European Safe Asset
  - Regulatory treatment of sovereign bonds

ECONOMIC UNION: REFORMS HAVE BEEN UNDERTAKEN SINCE THE CRISIS, ESPECIALLY IN CRISIS-HIT COUNTRIES

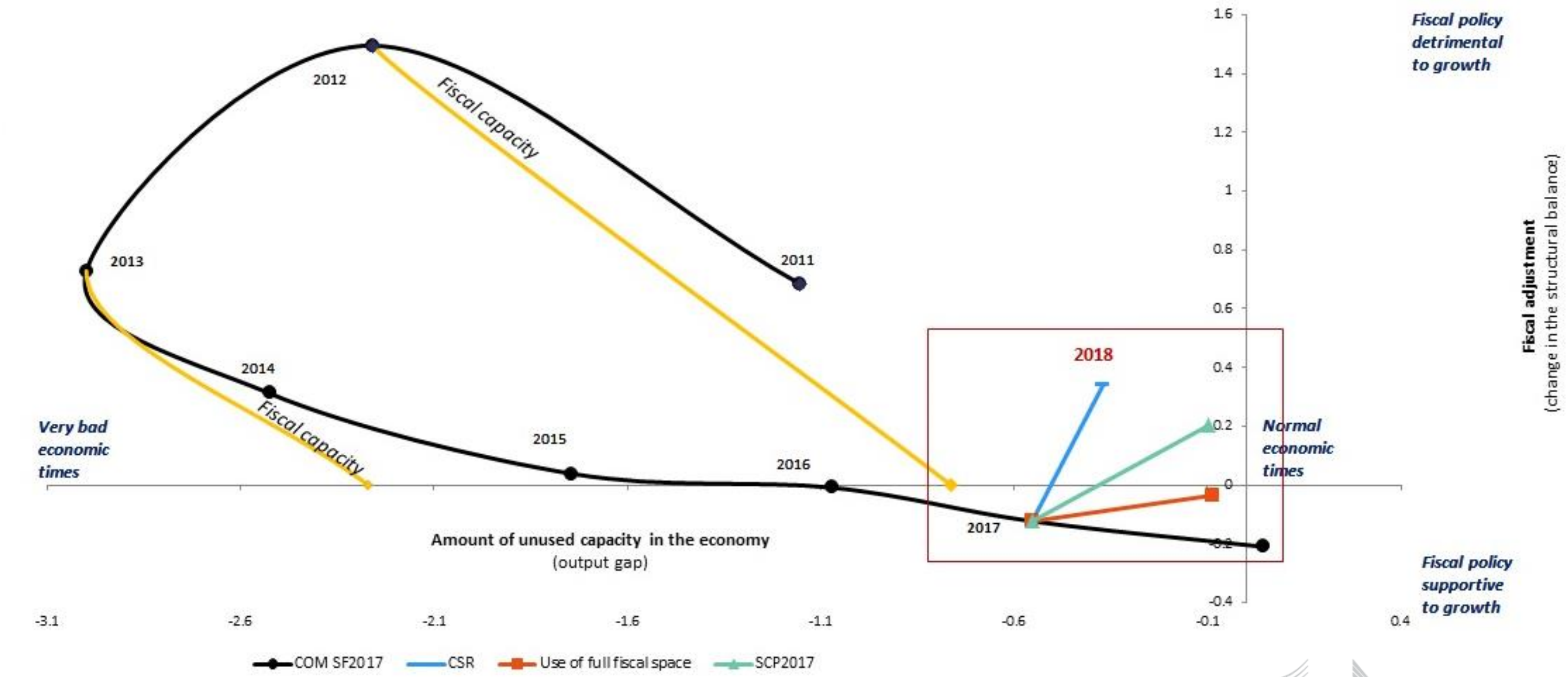


Source: OECD, Commission Labref database

ECONOMIC UNION

- Economic rationale for improving further the economic union:
    - Potential for stronger convergence
    - Increased economic resilience in case of future crises
- Strengthening convergence and resilience by better using existing tools:
    - Economic policy coordination– more dialogue, stronger euro area dimension, multi-annual approach
    - EU budget – stronger link between funding and reforms
    - Technical assistance
- New tools in the longer term:
    - Five Presidents Report: binding convergence standards

FISCAL UNION: A FISCAL CAPACITY?



FISCAL UNION

- Rationale behind a fiscal Union (Reflection paper on the deepening of the EMU):
  - i) sound public finances and the existence of fiscal buffers which help economies to be more resilient to shocks;
  - ii) complementing common stabilisation tools at the level of the euro area as a whole;
  - iii) the combination of market discipline and of a shared rulebook which would allow these rules to be more effective and simpler to understand and operate.
- In the longer term: review of EU fiscal rules
- Transformation of the European Stability Mechanism into a European Monetary Fund

European Commission

GOVERNANCE AND ACCOUNTABILITY

- The ESM should now progressively graduate into a European Monetary Fund which, however, must be firmly anchored in the European Union's rules and competences.
- A European Minister of Economy and Finance:
  - promotes and supports structural reforms in Member States, building on the work the Commission's Structural Reform Support Service
  - should coordinate all EU financial instruments that can be deployed if a Member State is in a recession or hit by a fundamental crisis.
  - ideally also a VP, who should also preside the Eurogroup.
  - must be accountable to the European Parliament.

European Commission

European Commission

EMU ROADMAP: BROAD OVERVIEW

By 2019

- NPL strategy
- Common backstop Single Resolution Fund
- European deposit Insurance scheme (EDIS): agreement
- Capital Market Union finalisation
- Work on sovereign bond-backed securities

- Preparation of the new Multiannual Financial Framework (MFF)
- Proposal for the creation of a dedicated euro area budget line within the EU budget

- Stabilisation function: reflection

- Steps: integrate the Fiscal Compact in EU law
- Proposal: transform the European stabilisation mechanism (ESM) in a European Monetary Fund (EMF)

2020-2025

- Capital Market Union (CMU): implementation
- European deposit Insurance scheme(EDIS): roll-out
- Possible euro area safe asset
- Changes to the regulatory treatment of sovereign exposures

- New Multiannual Financial Framework (MFF)
- New convergence standards linked to a central stabilisation function

- Stabilisation function: implementation
- Stability and Growth Pact (SGP) simplification

- Unified external representation
- Possible permanent European Minister of Economy and Finance and institutional implications

AN ACCELERATED STEP BY STEP APPROACH

The US and the USD	The EU and the EURO
1776: Declaration of independence. The US are 241 years old	1967: Treaty of Rome. The EU has just celebrated its 60th birthday
1791*: Congress establishes the First Bank of the United States on the impulse of treasury secretary Alexander Hamilton. 1792: USD coinage act	1971: The Werner report puts forward the first proposal of a Monetary Union 1979: European monetary system
1913: President Wilson signs the Federal Reserve Act into law 1917: Small central government budget** (>5% GDP) 1932: 1st time US federal budget used in a counter-cyclical manner 1934: Federal Deposit Insurance Corporation (FDIS)	1998: The European Central Bank is founded 1999: Creation of the Euro 2002: Euro in circulation 2012: Banking Union, ESM 2015: EDIS

* Though not a central bank, its power and scope made it a precursor of the FED
** Without military spending
Source: Kirkegaard (2018, forthcoming), Gelpern and Véron (2018, forthcoming)

European Commission

LESSON FROM THE US: FISCAL UNIONS TAKE A LONG TIME TO CONSTRUCT AND THE IMPACT OF WARS IN THE US IS NO BENCHMARK FOR THE EU

Source: Kirkegaard (2018, forthocoming), Williamson (2014). Expenditure data from 1792-1945 , US Census (1949); 1945-2020p OMB (2015).

CONCLUSION

- Better economic times and stronger financial stability: defy the "Ultima ratio"
- Creating bridges makes sense politically and economically
- Populist pressures should not be underestimated but we have a chance to relaunch Europe
- Main goals: complete EMU (BU in primis), foster reforms to lift potential growth, deliver on new EU public goods
- Lesson from US history: virtue of patience

European Commission