DEEPENING OF THE EMU: ARE BANKING UNION AND FISCAL UNION SUBSTITUTES OR COMPLEMENTS?

Marco Buti
DG Economic and Financial Affairs, European Commission

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**EMU today: An unstable equilibrium**

- Insufficient private and public risk-sharing
- Overburdening of monetary policy
- Risk of renewed financial instability

My talk: B
Financial union: the most urgent priority for EMU

Smoothing income shocks via financial markets remains low

Cross-border risk sharing through different channels, in % of total asymmetric shock to output

Fiscal union
Benefits of a central stabilisation capacity

Very bad economic times

Normal economic times

Amount of unused capacity in the economy (output gap)

Fiscal adjustment (change in the structural balance)

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ARE FINANCIAL AND FISCAL UNION SUBSTITUTES OR COMPLEMENTS?

- Portfolio diversification and capital movement help absorb shocks in "normal" times but tend to be procyclical in "bad" times.

- Central stabilisation can foster private risk-sharing (cross-border ownership of assets) by reducing country specific macro-risks (better smoothening of large asymmetric shocks and less need for state pro-cyclical fiscal adjustment).

- Fiscal insurance to tackle and reduce shocks arising from the real economy before they reach the financial sector.

- EMU financial union unlikely to look like in the US in the medium-period (some degree of home-bias will stay, financial system to remain bank-centred).
Next Steps: Financial Union
Advancing in parallel on risk-reduction and risk sharing

False dichotomy between risk-sharing and risk-reduction

**Immediate priority**
- Further reducing risks and building on banks' better capitalisation
- Setting up the backstop to the SRF
- Agree on EDIS
- Delivering on the Capital Markets Union (CMU)

**Post-2019: possible additional successive measures**
- European Safe Asset
- Regulatory treatment of sovereign bonds
Next Steps: A European stabilisation function to protect investment
Future of EU Fiscal Governance: Searching for the right balance

**Elements of centralisation**
- Simplified fiscal rules
- A common fiscal capacity
- Last resort backstop to the banking union
- Reinforced ability to intervene in case of gross errors

**Elements of decentralisation**
- Operational national rules with links to the EU framework
- More binding nature of medium-term fiscal planning at MS level
- Empowered independent national fiscal institutions
- Reinforced market discipline

**Fiscal federalism by exception vs No bail out/market discipline**
Thank you very much for your attention