EMU AFTER THE EU ELECTION CYCLE – THE WAY FORWARD

Marco Buti
DG Economic and Financial affairs, European Commission

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1. 2016-2017: the years of all dangers
2. An economic recovery with crisis legacies
3. Moving forward by completing EMU
4. Embedding EMU into new European public goods
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? Not necessarily so
- The Eastern European conundrum
- Populists have one thing in common: they are against Europe
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
OUTLINE

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EURO AREA RECOVERY 'TWO YEARS BEHIND US' AND INCREASINGLY BROAD-BASED
STRONG RECOVERY, HOWEVER CONDITIONS FOR SUSTAINABLE AND INCLUSIVE GROWTH ARE NOT YET THERE
CONDITIONS IN PLACE TO DEAL WITH FISCAL AND FINANCIAL FRAGILITIES

- Public debt
- Deleveraging needs
- Fiscal space
- Budget deficit
- NPLs
- snowball risk
- Bank profitability space
- LT Interest rates

DE
EA
IT
FR

European Commission
NEED OF A MORE SYMMETRIC REBALANCING IN THE EURO AREA
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TWO COMPETING MODELS FOR EMU

"Back-to-Maastricht"

- Stronger enforcement of EU fiscal rules to rein debt and deficits
- MIP focused on competitiveness of lagging countries
- Banking Union does not need common deposit insurance
- End to the risk-free status for sovereign debt and establish sovereign debt restructuring mechanism
- More market discipline

Fast forward to federalist EMU

- Distribution of fiscal efforts to achieve an appropriate aggregate fiscal stance
- Symmetric adjustment to help weak countries and reduce Euro area current account surplus
- Full Banking Union to ensure financial stability and private risk sharing
- Fiscal capacity for public risk sharing and eventually sovereign debt mutualisation
- Euro area Treasury
A NEW POLITICAL SYNTHESIS IS NEEDED

Risk Sharing and risk reduction

Financial Union

Economic Union

Fiscal Union

Reforms and incentives

Sound budgets and fiscal capacity
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
FINANCIAL UNION: INTERNATIONAL COMPARISON

Size in % of GDP
- Stock market capitalisation
- Debt securities
- Bank assets

Source: IMF
FISCAL UNION

Rationale behind a fiscal Union (Reflection paper on the deepening of the EMU):

i) sound public finances and fiscal buffers indispensable for a monetary Union;

ii) common stabilisation tools at the level of the euro area;

iii) combination of market discipline and common simple rules
BENEFITS OF A CENTRAL STABILISATION CAPACITY

- Fiscal adjustment (change in the structural balance)
- Amount of unused capacity in the economy (output gap)

Very bad economic times

Normal economic times

- COM SF2017
Strengthen economic resilience and avoid divergences

Better use of existing tools:

- Economic policy coordination – more dialogue, stronger euro area dimension, multi-annual approach
- EU budget – stronger link between funding and reforms
- Technical assistance
THE EURO AREA RESILIENCE SPECTRUM

ADAPTABILITY
• Shock Absorption
• Reallocation

Vulnerability
THERE IS SCOPE FOR INCREASING EMU DEMOCRATIC LEGITIMACY

- The ESM to progressively graduate into a European Monetary Fund firmly anchored in the European Union
- A European Minister of Economy and Finance:
  - promotes and supports structural reforms
  - should coordinate all EU financial
  - Streamline existing positions (Commissioner and Eurogroup President)
  - accountable to the European Parliament.
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Two most important issues facing the EU at the moment (%):

- Terrorism: 44%
- Immigration: 38%
- Economic situation: 18%
- Public finances: 17%
- Unemployment: 15%
- Crime: 10%

Source: Standard Eurobarometer 87
NEW EUROPEAN PUBLIC GOODS

Further cooperation on terrorism and more broadly on security and defence
   • Establishment of a European Defence Fund as a permanent structured cooperation
   • Cooperation reduces pressure on public budgets

Common policy on migration
   • Commission provides affected member states with financial support and technical assistance
   • Migration helps address demographic challenges

Boosting investments and deepening market integration
   • European Fund for Stability and Investment (EFSI 2.0): Expanding support of strategic investment beyond 2020
   • Strengthening SMEs and Europe's industrial base creates jobs
CONCLUSION

- Populist pressures should not be underestimated but we have a chance to relaunch Europe
- A comprehensive package needed to reach an agreement
- Creating bridges makes sense politically and economically
- Main goals: complete EMU (BU in primis), foster reforms to lift potential growth
- Deliver on new European public goods
- Better economic times and stronger financial stability: defy the "Ultima ratio"
BACKGROUND
COMMENDING THE ECONOMIC AND MONETARY UNION

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

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

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

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

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

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

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