Euro@20

Marco Buti
Direttore Generale
Direzione per gli Affari economici e finanziari
Commissione europea

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Content

1. $EMU@20 = EMU@10 + 10$
2. Did EMU change policy behaviours?
3. Euro area throughout the crisis
4. Reforms during the crisis and way forward
EFFICIENCY ++
(but certain aspects, like productivity/reforms fully decentralised)

STABILISATION +
(only based on monetary policy and automatic stabilisers)

EQUITY 0
(interpersonal fully in the hands of Member States; cohesion between countries in EU budget)

SUSTAINABILITY/STABILITY +++
(necessity of supranational fiscal rules to secure sustainability and protect monetary policy from deficit bias and debt spillovers/ ECB as the most independent CB in the world)
Institutional setting in EMU (strong version of the “consensus” on policy making of the 80s’ – see Buti Sapir 1998)

i) Monetary Policy (centralised) by independent central bank instrumental to credibly bring down inflation <= conservative, independent central bank to bring down inflation, Barro-Gordon (1983), Rogoff (1985)

ii) Fiscal Policy (decentralised) action limited to automatic stabilization (normal cycles) <= Barro (1979)

iii) Ban on excessive government deficits & on monetary financing of government deficits <= avoid fiscal dominance and no government bailout, Sargent & Wallace (1981)


v) Competition (trade and internal market) increases efficiency, OCA criteria are endogenous <= Cecchini Report (1988), Frankel & Rose (1998)
Our early beliefs... and what happened in the first 10 and then 20 years

<table>
<thead>
<tr>
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<th>EMU@0: our beliefs</th>
<th>EMU@10</th>
<th>EMU@20</th>
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<tbody>
<tr>
<td><strong>Efficiency</strong></td>
<td>- Financial markets as shock absorbers</td>
<td>- Anaesthetic effect of EMU on structural reforms</td>
<td>- Destabilising role of financial markets</td>
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<td></td>
<td>- Improve resource allocation</td>
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<td>- Shock propagated in the crisis</td>
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<td>- Uptake of structural reforms</td>
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<td>- Capital allocation not always efficient</td>
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<td><strong>Stabilization</strong></td>
<td>- House in order allows automatic stabilisers to address country-specific shocks</td>
<td>- Lack of fiscal buffers</td>
<td>- Need of a central stabilization function</td>
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<td>- Aggregation of national fiscal stances do not necessarily give an</td>
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<td></td>
<td></td>
<td>adequate EA stance</td>
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<tr>
<td><strong>Equity</strong></td>
<td>- Limited / restricted to real convergence</td>
<td>- Too optimistic on real convergence (endogenous OCA)</td>
<td>- Limited convergence</td>
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<td></td>
<td>- Redistribution done by MS</td>
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<td>- Adjustment born by crisis countries</td>
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<td><strong>Sustainability</strong></td>
<td>- Credibility of the central bank</td>
<td>- Established credibility of the ECB</td>
<td>- Fiscal benefits of euro accession largely spent</td>
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<td><strong>Stability</strong></td>
<td>- Expectations that MS would maintain sustainable public finances</td>
<td>- Unsustainability of internal imbalances</td>
<td></td>
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<tr>
<td></td>
<td>- No consideration of internal imbalances</td>
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Content

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Improvement in prosperity broadly at par with the US, but convergence with the US stalled

**GDP per capita growth (%)**

- European Union
- Euro area (EU-19)
- US

**GDP per capita (in pps, US=100)**

- European Union
- Euro area (EU-19)
- US

Source: Ameco
Credibility of the Central Bank

Dispersion of HICP inflation

Notes:
Dispersion measured as an unweighted standard deviation.
2018/19 projected values according to Autumn 2018 forecast.
EA changing composition: according to entry date in EA
Source: Ameco
Not all MS improved sufficiently in public finance sustainability

Data source: AMECO
Real convergence mostly driven by 'new' euro area Member States

Note: Countries which were in 1999 (left chart) and in 2008 (right chart) not members of the euro area are highlighted in red. The black regression line is based on the full sample of countries, the blue one excludes the 'new' euro area Member States, which are highlighted in red.

Source: Eurostat.
Imbalances and resource allocation

Increasing imbalances

Cumulative growth rate of non-tradable/tradable value added

Source: Commission calculations based on AMECO and Eurostat
Content

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Origin of the EA crisis: my preferred reading

• A "sudden stop" crisis following capital misallocation in pre-crisis years

• A banking crisis triggered a feedback loop: bank solvency concerns → higher bond yields and debt service → default worries → deeper recession

• The euro-area crisis was not a fiscal crisis (apart from Greece), but lack of fiscal space hindered the policy response during the crisis

• Heterogeneity in the euro area much larger than assumed before the crisis: different growth models and agglomeration effects

• Structural divergences during the first 10 years of EMU led to divergent social and political preferences → "ultima ratio" mode
Upon sudden stops, short-term flows were replaced by central bank lending

* start in 2002, ** start in 2004
Source: Eurostat
ECB intervention: rates and balance sheet

ECB policy and euro overnight rates, Eurosystem BS size

Source: Macrobond, ECB
Fiscal policy tend to be pro-cyclical

Fiscal stance over the economic cycle, EA 2011-2018e

Source: Commission calculations based on spring 2018 Commission forecast
Structural reform uptake

Source: OECD (PMR)
Programs: the euro-area crisis was not a fiscal crisis (apart from Greece)

Five financial assistance programmes

Ireland: €85bn, exit in 2013

Portugal: €78bn, exit in 2014

Spain: financial sector support; €40bn, exit in 2014

Greece: 1st €110bn in 2010, 2nd €172.6bn in 2012 and €86bn in 2015 €, exit in 2018

Cyprus: €10bn, exit in 2016;
Content

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EMU reform during the crisis: an overview

**Sound fiscal policy**

- More effective prevention of gross policy errors
  - Focus on structural balances
  - Expenditure benchmark
- Better enforcement of SGP rules
  - Sanctions
  - Two Pack: ex ante submission of draft budgets, closer monitoring
  - National layer: Directive on fiscal frameworks, Fiscal Compact

**Focus on debt developments**

- Debt reduction benchmark

**Crisis resolution instruments**

- EFSM/EFSF: temporary
- ESM: permanent
- ECB: OMT

**More effective supervision and regulation of the financial system**

- ESAs - ESRB - CRD IV
- Banking Union: SSM; direct recaps by ESM

**Prevention and correction of macro imbalances**

- Procedure and sanctions

**Structural reform strategy (Europe 2020)**

- Balanced growth

- European Semester for economic policy coordination

- Growth Compact (EIB, Structural funds, Projects bonds)

**Growth Compact**
**Two competing models for EMU**

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<tr>
<th>&quot;Back-to-Maastricht&quot;</th>
<th>Fast forward to federalist EMU</th>
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<tr>
<td>Stronger enforcement of EU fiscal rules to rein debt and deficits</td>
<td>Distribution of fiscal efforts to achieve an appropriate aggregate fiscal stance</td>
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<td>Mechanism of imbalances procedures (MIP) focused on competitiveness of lagging countries</td>
<td>Symmetric adjustment to help weak countries and reduce Euro area current account surplus</td>
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<td>Banking Union does not need common deposit insurance</td>
<td>Full Banking Union to ensure financial stability and private risk sharing</td>
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<td>End to the risk-free status for sovereign debt and establish sovereign debt restructuring mechanism</td>
<td>Fiscal capacity for public risk sharing and eventually sovereign debt mutualisation</td>
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<td>More market discipline</td>
<td>Euro area Treasury</td>
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In their « pure » form, both are economically and/or politically unfeasible
To enter into the adult age of the Euro, the institutional framework is to be profoundly reinforced.

1. Financial Union
   - Diversified banks' sovereign exposures

2. Economic and Fiscal Union
   - Economic and social convergence

3. Institutions and Governance
   - Accountable institutions and effective governance

   Complete Banking Union and Capital Markets Union

   European safe asset, Not €bonds

   Common fiscal stabilisation function
Completing the Financial Union

Economic objectives

Private risk sharing

Reallocation of excess savings via equity

EU initiative

Banking Union

Capital Market Union

Delivered
SSM, SRM

Pending
EDIS, SRF backstop

Delivered
Action plan 17 proposals

Pending
14 still on-going

Instruments
The evolving EA fiscal framework

*Increased adaptability at the expense of simplicity...*

**CLARITY**
(simplicity)

**ADEQUACY**
(adaptability)

**PREDICTABILITY**

- **SGP.0** (1997)
- **SGP.1** (2005)
- **SGP.2** (2011-)
- **Current rules**
Impact of a central stabilisation capacity in bad times

Fiscal stance over the economic cycle, EA 2011-2018

Source: Commission calculations based on spring 2018 Commission forecast
Possible forms for a European safe asset

Source: Buti, Deroose, Leandro and Giudice (2017)
## Deliverables of the EA summit in December

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<th>Deliverables</th>
<th>Key issues for decision</th>
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| **Single Resolution Fund (SRF) backstop**        | • Decision-making process  
• Conditions for early introduction  
• Maturity of the loans and pricing                                                                                                                                |
| **ESM reform**                                   | • Eligibility criteria for precautionary credit line  
• Financing terms for the instruments  
• Cooperation between the ESM and COM within and without programmes                                                                                         |
| **Banking Union**                                | • Progress in reducing legacy asset risks  
• Actions to increase prudential and anti-money laundering frameworks  
• Consensus on the need for EDIS but strong disagreement on the pre-conditions  
• Solution framework for liquidity in resolution                                                                                                               |
| **EA budget**                                    | • Objectives include competitiveness, convergence and stabilisation  
• Discussions on the design and characteristics of possible instruments and limited consensus so far                                                                 |
Conclusion

• Crisis is over, but the job is not yet done
• EMU deepening is an unfinished business
• Overcome creditors/debtors divide
• Additional difficulties in a multi-layer governance. Discount rate of COM < than that of Member States
• Key ingredient: trust to be rebuilt (Habermas’ definition of solidarity)
Thank you for your attention