"Completing EMU: Fiscal Union, Financial Union, Risk Sharing"

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Outline

1. Slowly exiting the worst crisis since the 1930s
2. Reforming EMU
3. Banking Union and Capital Markets Union
4. Fiscal Union
5. Summing up
1. SLOWLY EXITING THE WORST CRISIS SINCE THE 1930s
A difficult transition

- Slow recovery and lower growth
  - Euro area vs US
  - Risk of debt/ deflation trap?
  - Weak and declining TFP

- Weak banks
  - High NPLs
  - Structural weaknesses

- High debt legacy
  - Low fiscal space
  - Deleveraging still ongoing
Slower growth in the euro area than in the US – but substantial differences among members

Source: AMECO and ECFIN calculations.
The legacy of debt

Public debt before and after the crisis (%GDP)

Public and private debt in the EU, average (%GDP)

Source: AMECO and ECFIN calculations.
Inequality and Welfare

Global income growth from 1988 to 2008

- Booming global elite
- Decline of developed world middle-class
- Rising incomes in emerging economies, mainly China
- Very poorest locked out of growth

NEET rate, age group 15-24

Source: AMECO and ECFIN calculations.
2. REFORMING EMU
The crisis hit EMU in its infancy: fixing the engine while flying – steps taken so far

- **Crisis management**
  - EFSF + EFSM
  - European Stability Mechanism

- **Crisis prevention**
  - European semester
  - Fiscal framework reform
  - Macroeconomic imbalance procedure
  - Macroprudential supervision
  - Banking Union (single supervision + resolution)
Bridging different positions

**Solidarity**

**Discipline**

**Long-term reform**

**Rules**

**Supply (potential growth struct. ref.)**

**Political Union**

**Demand (cyclical/macro)**

**All MS (symmetric adjustment)**

**Secondary law**

**Community framework**

**Euro area**

**Maintaining sovereignty**

**Discretion**

**Discipline**

**Long-term reform**

**Rules**

**Supply (potential growth struct. ref.)**

**Political Union**

**Only vulnerable MS (asymmetric adjustment)**

**Treaty changes**

**Inter-governmental**

**European Union**
Differences of opinion contributed to the "Ultima Ratio" Logic

**DENIAL**

"It's an American crisis, not an euro area one"

**PUT YOUR HOUSE IN ORDER**

"Correct fiscal profligacy in peripheral countries"

**ACKNOWLEDGEMENT OF A COLLECTIVE PROBLEM, BUT TOO LITTLE TOO LATE**

Greek Loan Facility

**BOLD SOLUTIONS FACING THE ABYSS**

ESM, BU
"Whatever it takes"

**BACKTRACKING WHEN SITUATION IMPROVES**

Current phase?
3. BANKING UNION AND CAPITAL MARKETS UNION
Different smoothing effects: euro area vs. US

- Unsmoothed part in euro area much bigger than in the US.
- Cross-border borrowing channel similar.
- Cross-border fiscal channel virtually non-existing.
- Cross-border capital channel much smaller because financial union incomplete.
Banking Union - architecture

Banking Union

- Single Supervisory Mechanism
- Common Deposit Guarantee Scheme (EDIS) - still missing -
- Single Resolution Mechanism

Common rules for EU28 (Single Rulebook):

- CRR/CRDIV
  Capital Requirements Regulation and Directive
- BRRD
  Bank Recovery and Resolution Directive
- State aid
- DGSD
  Deposit Guarantee Scheme Directive

Macro-prudential policy framework
Banking Union – steps to completion

- Common (public) backstop for bank resolution operations
- Deepen Banking Union (single rulebook, review of macroprudential competences etc.)
- Integrate into EMU: White Paper on next steps of EMU integration (fiscal capacity, euro area treasury, etc.)
Capital Markets Union

- Part of the Investment Plan for Europe ('Juncker Plan')

- Further cross-border integration in order to strengthen cross-border risk-sharing (safe and transparent securitisation; EU legislation for venture capital etc.)

- Future steps to solidify bank re-financing, enhance monetary policy and cross-border diversification (European personal pension product, strengthening covered bond markets, single European capital markets supervisor etc.)
4. FISCAL UNION
Budget-related cross-border flows: EU vs. US

Average yearly cross-border flows operated through EU and US budget 2009-2010

Source: D’Apice, Pasquale (2016). Budget-related cross-border flows: EU vs. US
Deepening EMU to complement national stabilisers: A fiscal capacity

**What for?** Limited to unusual circumstances? Stabilise large country-specific shocks and/or common shocks?

**How?** Different dimensions and concepts
- Stabilisation function based on unemployment
- Investment capacity
- Provision of public goods (e.g. security-related)

**Key challenges:**
- No permanent transfers
- Beware of moral hazard – ensure fiscal discipline
- What degree of automaticity and conditionality?
5. SUMMING UP
Bridging differences: Parallel progress on risk sharing and risk reduction

• SGP enforcement at national level can be more efficient and more legitimate if completed with a central risk sharing tool

• More private risk sharing via Banking Union and Capital Market Union allows less fiscal risk sharing

• More fiscal risk sharing prevents overburdening the ECB