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#EUROat20

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The Design of Economic and Monetary Union

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Relevance of institutional frameworks

i. **Institutions matter:** recent times have provided ample evidence around the world for how important they are in determining the environment in which central banks operate

ii. **Institutional reform has become a policy variable:** fixing deficiencies in institutional frameworks is key to ensuring effective economic policies

iii. **The Economic and Monetary Union and its experience during the crisis provide ample evidence** for i) and ii).

Starting with a piece of good news

20 Years of the EURO

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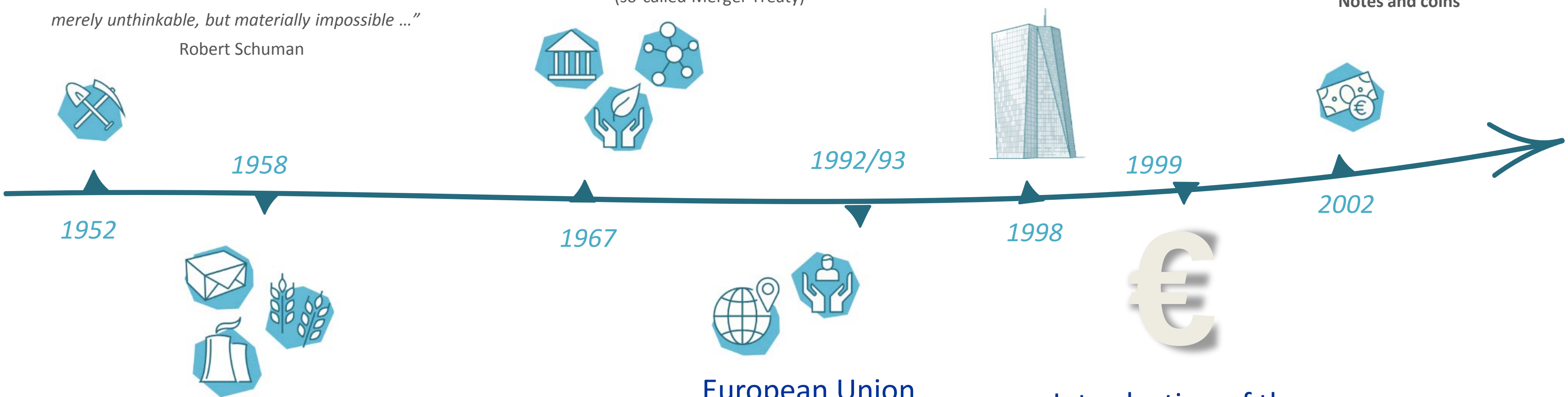
A bit of history

European Coal and Steel Community
Treaty of Paris
"make war between France and Germany […] not merely unthinkable, but materially impossible …"
Robert Schuman

European Communities
Treaty of Brussels
(so-called Merger Treaty)

European Central Bank
Established on 1 June 1998

Introduction of the Euro
Notes and coins



European Economic Community
European Atomic Energy Community
Treaties of Rome

European Union
Treaty of Maastricht

Economic and Monetary Union

Single Market

EU accession criteria
Copenhagen criteria

Introduction of the Euro
Virtual Currency

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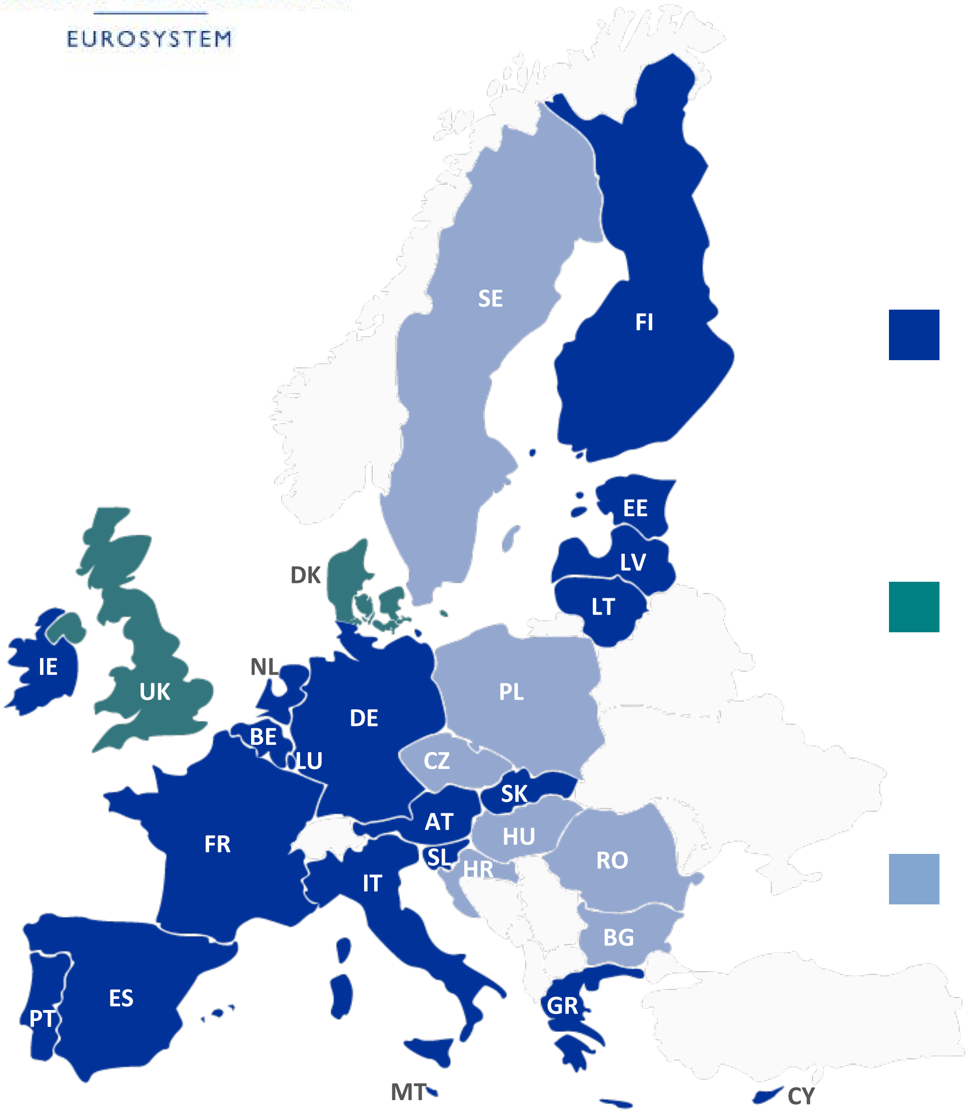
Current euro area members



EU Member States which have adopted the euro

EU Member States with a special status

EU Member States with a derogation

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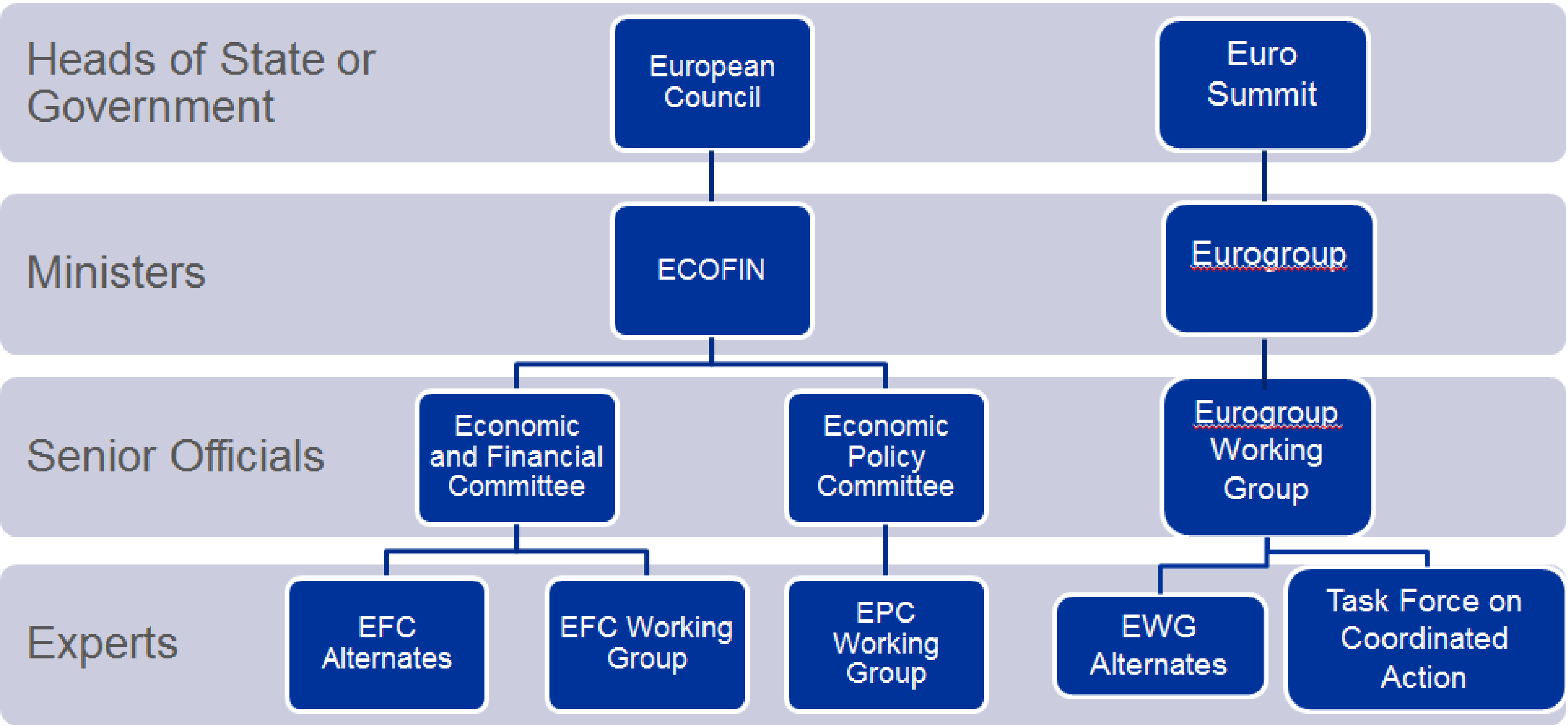
Representation of Member States the Council



Direct representation of citizens: the European Parliament

- **Strong role in economic and financial legislation** (co-decision powers and contribution to agenda-setting)

- **Accountability function for EU institutions** (e.g. European Commission, ECB)

- **Very limited role in intergovernmental coordination** (e.g. economic dialogues)

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Overview

1	The rationale for Economic and Monetary union
2	Initial design and reforms during the crisis
3	Completing the Economic and Monetary Union

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1 The rationale for Economic and Monetary union

A political project

The euro is the most tangible symbol of European unity and identity.

341 million people use
the euro in 19 countries.

“The euro is the most tangible representation of European integration that our citizens encounter, on a daily basis. (…) Over the years, elected representatives and leaders (…) have rightly recognised that ensuring economic prosperity and stability over the long term is a shared challenge that is best faced collectively. We are stronger together.”

Mario Draghi, Speech at the European Parliament to mark the anniversary of the euro, 15 January 2019

Single Market, single currency

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Security of purchasing power	Removal of transaction costs
Price transparency	Elimination of exchange rate risks

"With the Single Market, we have a powerful engine of sustainable growth to underpin our living standards. The euro has safeguarded the integrity of the Single Market. Today, our economies are integrated to a point that was not imaginable when the euro was designed. Intra-EU exports rose from 13% of EU GDP in 1992 to 20% today and value chains are everywhere in the euro area."

Mario Draghi, Speech at the European Parliament to mark the anniversary of the euro, 15 January 2019

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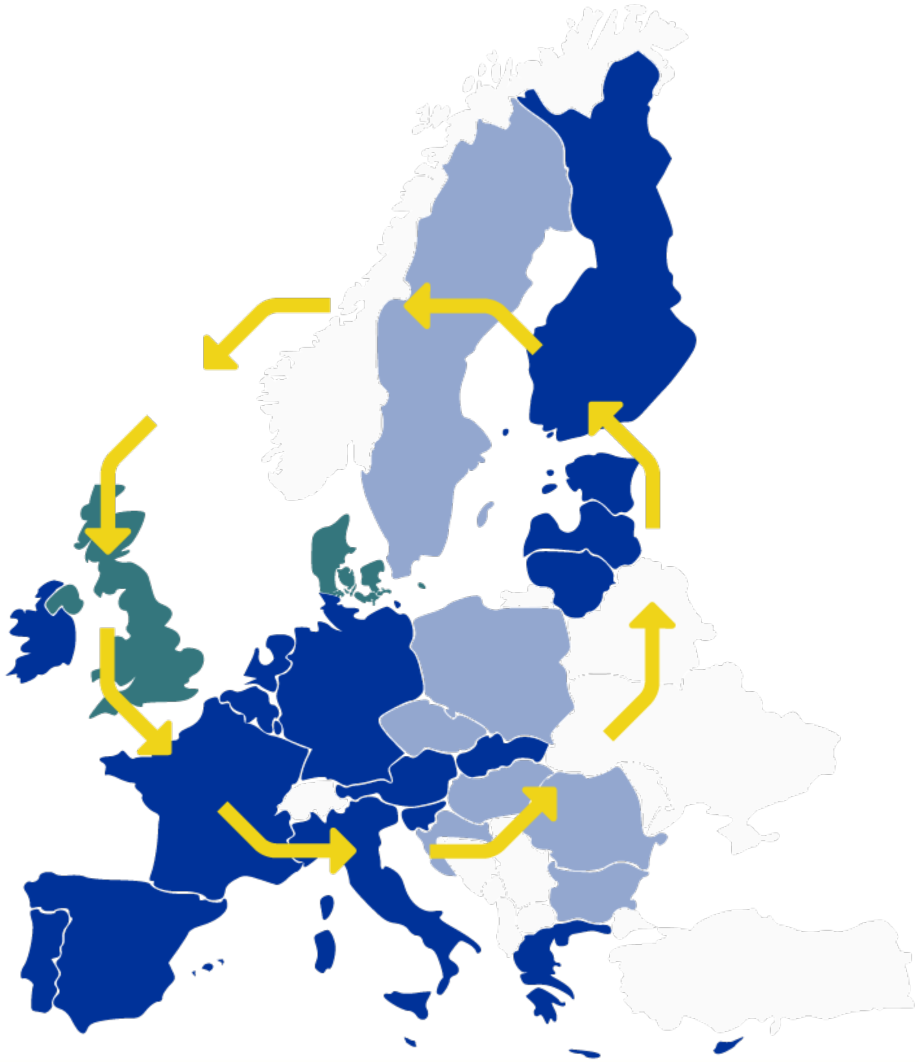
Financial integration

Integration of financial markets, financial infrastructures and financial institutions

- results in economies of scale, larger variety of financial products at lower cost
- enhances transmission of monetary policy impulses
- contributes to safeguarding of financial stability and smooth operation of payment systems



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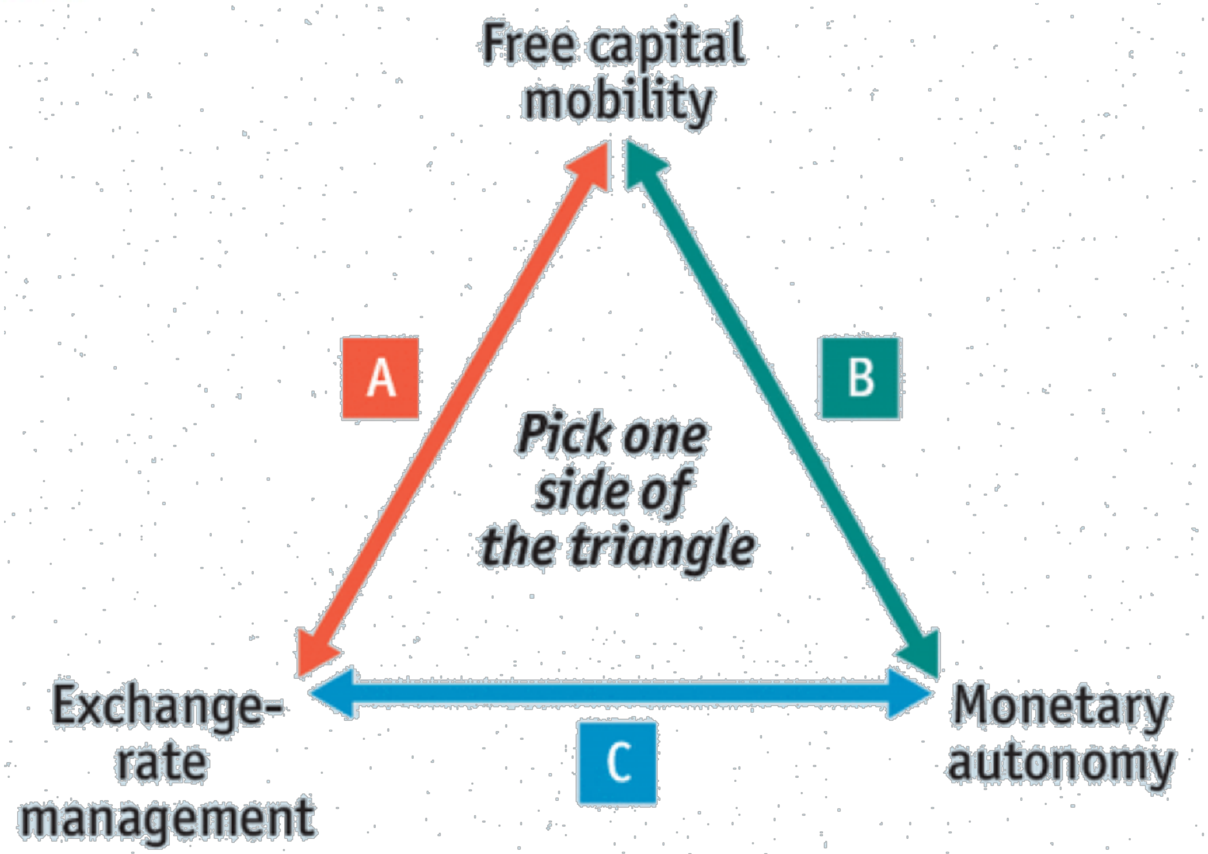
The impossible trinity



Source: The Economist

International relevance

The euro is one of the world's most widely-used currencies. The proportion of international payments made in euros and US dollars is roughly equal and the euro is the world's second most-used currency for borrowing and lending.

"Today most challenges are global and can be addressed only together. It is this "togetherness" that magnifies the ability of individual countries to retain the sovereignty over the relevant matters, sovereignty that would otherwise be lost in this global world. It is precisely in this sense that the single currency has given to all members of the euro area their monetary policy sovereignty, compared with the pre-existing monetary arrangements. It is together that we have a voice in the regulation of international financial markets (…)."

Mario Draghi, Speech at the European Parliament to mark the anniversary of the euro, 15 January 2019

A controversial project initially

- **Politically**: initial fears by part of the population of losing sovereignty and of price increases upon changeover

- **Economically:** concerns over risks of moral hazard and one size fits all; diverging views on whether EMU would foster economic convergence or divergence; debate on cost-benefit balance in light of optimal currency union theory

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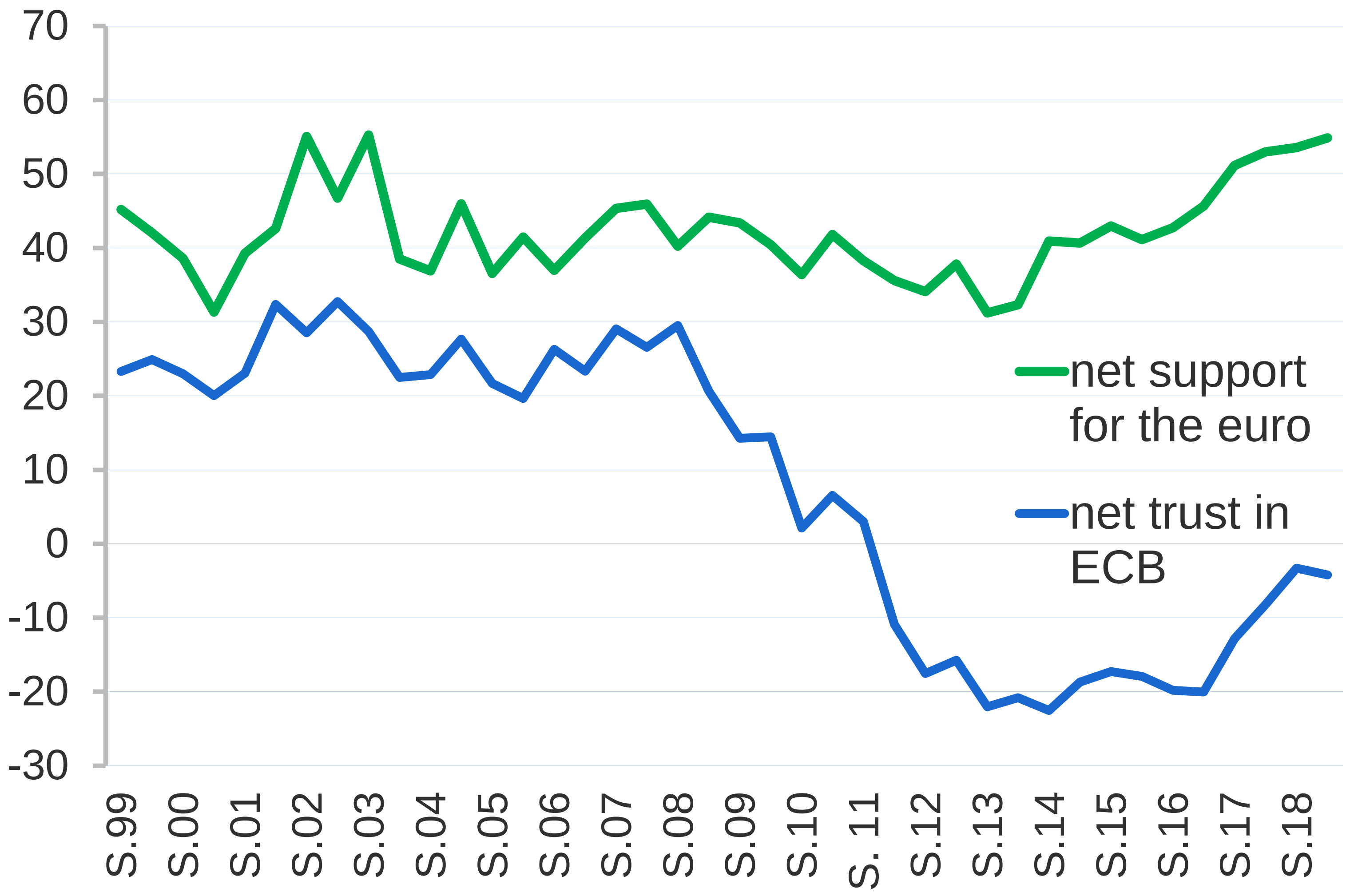
The euro now enjoys strong support…



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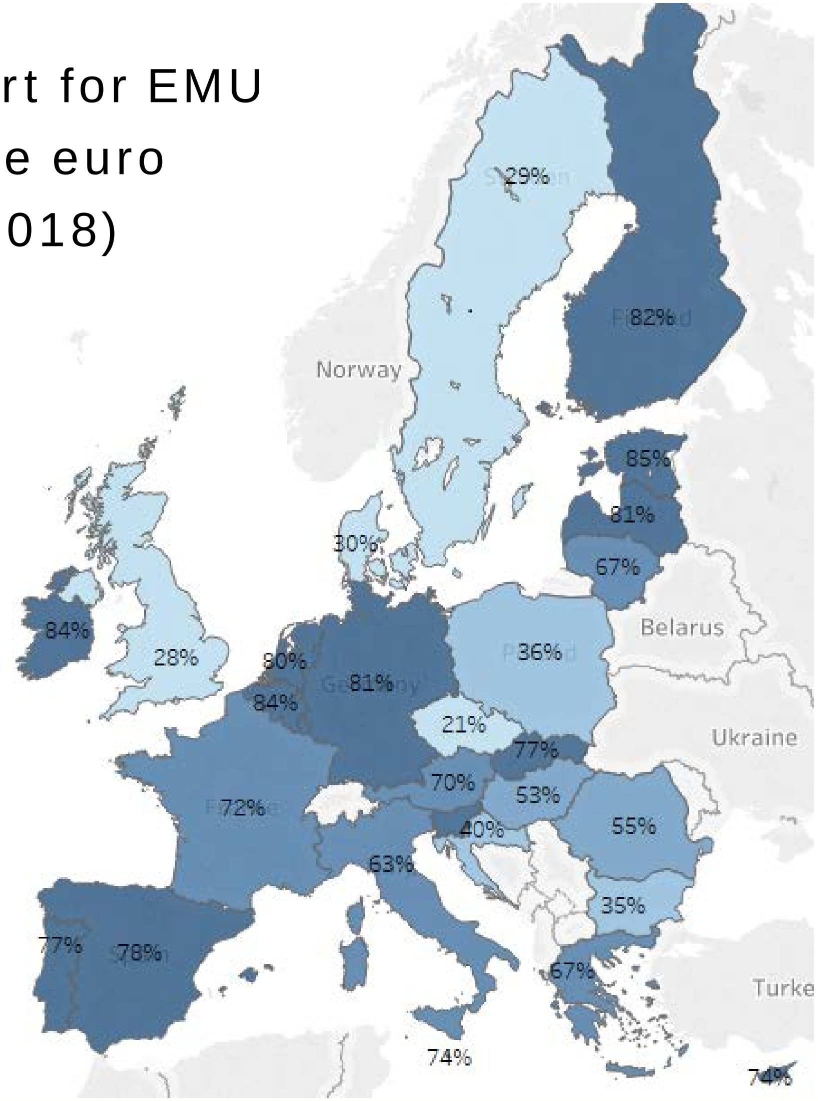
… across the euro area

Support for EMU
and the euro
(Nov 2018)



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2 Initial design and reforms during the crisis

Convergence criteria

Conditions for euro area accession

Sustainable convergence is assessed on the basis of:

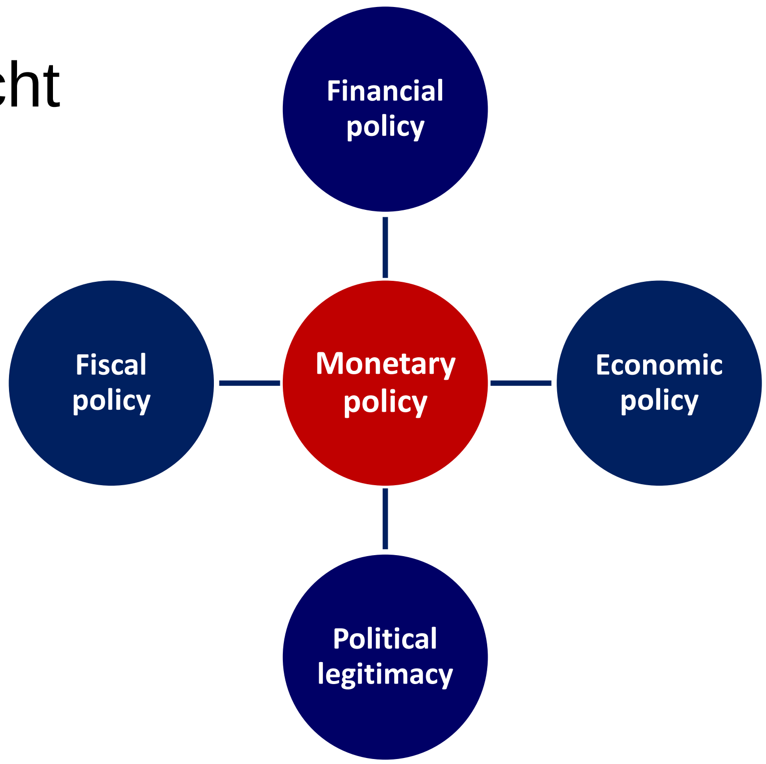
Price stability	Interest rate convergence
Public finance discipline	Exchange rate stability

Legal convergence

Pre-crisis framework (I)

A central monetary policy but decentralised financial, fiscal and economic policies with weak coordination

EMU of the Maastricht Treaty (1992)



Pre-crisis framework (II)

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And key principles designed to ensure appropriate incentives for policy making

EMU

- **Price stability** mandate of the central bank
- **Independence** of the central bank
- **Monetary financing prohibition**
- **'No bail-out' clause**

The crisis revealed the limits of the pre-crisis framework

1. Debt crisis (private and sovereign)

2. Banking crisis

3. Competitiveness and growth crisis

4. Political crisis (national & European levels)

Crisis of confidence

No easy or single remedy – Europe faced a decade of adjustment

Failures of the pre-crisis framework

1. Failure to enforce rules of fiscal policy framework -
   - Insufficient internalisation of EU rules at national level
   - Practice of “non-interference” and weak enforcement (sanctions never used)
2. Failure of market discipline
   - Presumption of rational behaviour
   - Solidarity vs. ‘no bail-out’ clause
3. Lack of a competitiveness framework
   - Lack of surveillance of competitiveness and macroeconomic imbalances
   - Processes of surveillance and coordination were non-binding
4. Insufficient integration of financial sector policies; unsatisfactory quality of banking supervision
5. No crisis resolution mechanism to provide financial support to EA countries

Crisis reforms: stronger fiscal and economic surveillance

"Six Pack"

- Strengthened Stability and Growth Pact
- Macroeconomic Imbalance Procedure (MIP)

Improved Coordination

- European Semester
- Euro-Plus-Pact

Fiscal Compact

- Mandatory balanced budget rule (structural deficit <0.5% of GDP)
- Reduction of debt/GDP ratio by 1/20th per year in case of public debt>60%

"Two-Pack"

- Strengthened oversight of countries under financial assistance
- Supervision and assessment of draft budget laws

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Crisis reforms:
Stronger financial surveillance

European System
of Financial Supervisors

Macro-prudential oversight

European Systemic Risk Board

- **ECB**
- **National central banks**
- **European Supervisory Authorities**
- **European Commission**

- National Supervisors (non-voting)
- EFC presiden (non-voting)
- Advisory Scientific Committee (non-voting)

Micro-prudential supervision

European Supervisory Authorities

- **European Banking Authority**
- **European Insurance and Occupational Pensions Authority**
- **European Securities and Markets Authority**
- **Single Supervisory Mechanism**
  National supervisory authorities

Crisis reforms:
Stronger crisis management tools

- Five euro area countries have received financial assistance during the crisis: Greece, Ireland, Portugal, Spain (for the Banking sector) and Cyprus.
- Reform programmes were monitored by the European Commission, the ECB and the International Monetary Fund
- In 2012 the European Stability Mechanism (ESM) was established, endowed with a capital up to €700 billion.
- Single Resolution Fund was created for banking crises

European Stability Mechanism

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3 Completing the Economic and Monetary Union

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Objectives

EMU

Financial union

- Break sovereign-bank nexus
- Foster private risk-sharing
- Create more resilient and efficient financial sector

Fiscal union

- Reduce country imbalances and vulnerabilities
- Create tools for macro-economic stabilisation

Economic union

- Reduce country imbalances and vulnerabilities
- Bolster shock absorption
- Increase potential growth

Political union

- Right balance of competences between European and national level
- Commensurate legitimacy arrangements

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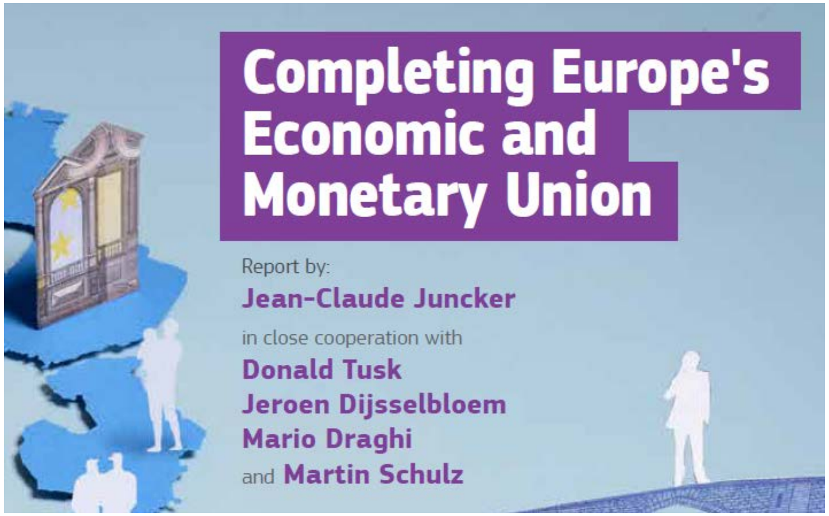
The Five Presidents' Report



- A EA system of competitiveness authorities
- A stronger MIP
- A streamlined European Semester

Economic Union

- Completing the Banking Union
- Launching the Capital Markets Union

Financial Union

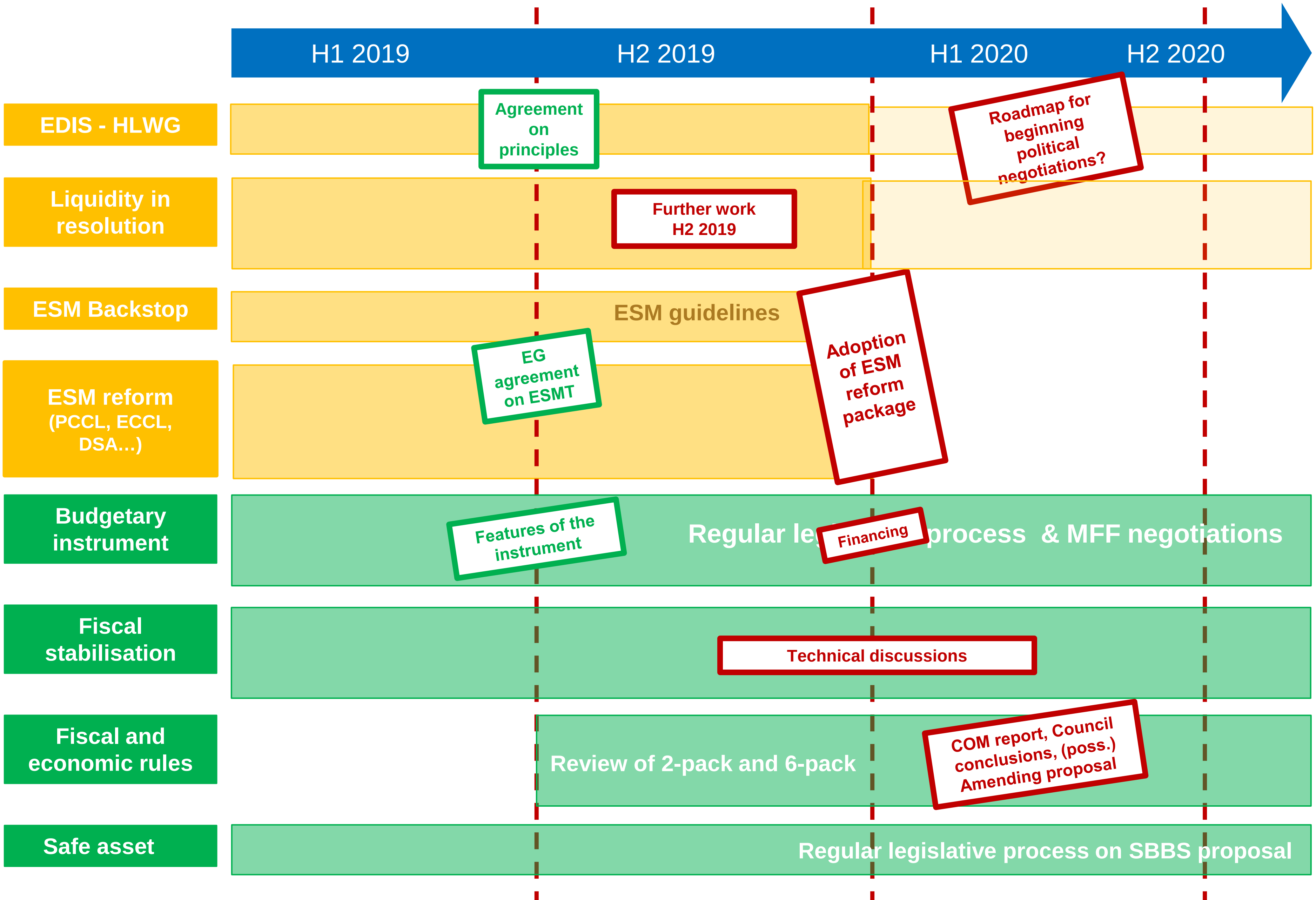
- A new advisory European Fiscal Board
- A fiscal stabilisation function for the euro area

Fiscal Union

- More accountability towards the EP and NPs
- Consolidation of Eurogroup
- A euro area Treasury

Political Union

Essential elements need to be further ironed out in 2019 and 2020



Conclusion: what is the momentum for EMU deepening?

Key drivers: urgency, salient issues, reviews of existing legislation

Conditions: willingness to compromise based on packages/sequencing

- **Crisis momentum** for EMU deepening **waning**
- The European Parliament and European Council are **more fragmented**
- **Trust** in EU and institutions **low but recovering**
- **Slow progress** - where could new momentum come from? Will resilience be tested?
- **Challenge to bridge differences of views** amongst the Member States
- Other emergent policy issues (environment, trade/single market, digitalisation, taxation, AML) **high on the agenda: provide a new angle for shaping EMU?**

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Thank you for your attention!