The euro area agenda - speech by Rolf Strauch

View PDF
07/10/2020
Speeches
ESM
Online

Rolf Strauch, ESM Chief Economist
"The euro area agenda"
The Werner Report, 50 years on
Online, 7 October 2020

(*Please check against delivery*)

Good afternoon,

Former Luxembourg Prime Minister Pierre Werner envisaged a phased approach to a complete European Economic and Monetary Union (EMU). He saw a common currency as the centrepiece of integration. He was correct. Today, the euro is the most prominent symbol of European unity worldwide.

We have all learned about the challenges to monetary union since the creation of EMU. The last decade saw Member States come even closer together, in order to resolve the problems of the financial and sovereign debt crises.

The current crisis looks different. Recent threats to economic stability, such as Brexit, Covid-19, or a political backlash to globalisation, seem to call mainly for overarching European action.

The pandemic has also given rise to an unprecedented European Union (EU)-wide response. Support packages have been put forward in the short run. The ESM is part of these measures. Yet the next long-term EU budget and “Next Generation EU” recovery fund, in particular, have taken centre stage. All European countries are now fighting the health crisis to contain, first and foremost, the human, and then the economic cost of the crisis.

It is, therefore, a good moment to ask what the needs of a genuine euro area agenda are, what its objectives should be, and how it complements EU efforts to resolve the pandemic and other global challenges.

I will argue that we should not lose sight of deepening EMU, even in current times. Both the euro area initiatives and debates – as regularly occur in the Eurogroup or Euro Summits – facilitate and complement European efforts.

I. The euro area agenda

While all European countries jointly confront the pandemic and face global risks, the euro area policy’s challenges and opportunities remain different from those of other EU countries in three respects.

First, the common currency and common monetary policy must work effectively. This has implications for the digitalisation of financial markets, for example, and more broadly for financial infrastructure and management.

Second, effective common monetary policy needs an integrated financial market. Largely diverging interest rates across member states in the past crisis meant that the monetary transmission did not work anymore.

And third, since euro area countries do not have control over monetary or exchange rate policy, a unique set of instruments for convergence and stabilisation are required.

In short, euro area countries have a greater need for economic and financial risk sharing through markets and mutual fiscal support than other EU countries.

Although we have come a long way, achieving the remaining elements of the existing euro area agenda remains a necessity. The key points, formulated before the pandemic, are well known.

A fiscal capacity for macroeconomic stabilisation would be an invaluable supplement to national fiscal policy, the sole remaining macroeconomic policy instrument for euro area countries.

This would provide countries with greater fiscal space during severe asymmetric downturns and mitigate the need for a damaging pro-cyclical policy.

It is possible to design this stabilisation capacity in a way that precludes permanent fiscal transfers and minimises moral hazard.

Such a central stabilisation capacity can take many forms – an ESM short-term credit line is one option, an advantageous one given that the ESM is a well-established institution.

We cannot rely on the Next Generation EU to perform that role. The EU recovery fund represents a major breakthrough in political willingness to issue sizeable amounts of supranational debt when the need arises. However, it is an exceptional and temporary instrument specific to the pandemic response and cannot function as the permanent stabilisation facility that the euro area needs.

The completion of banking union is key to the euro area agenda. The existence of a single supervisor for euro area countries and the requirement to join banking union when a country accedes to EMU show the relevance of a functioning common banking market for monetary union.

Crucial to the completion of banking union is the backstop to the Single Resolution Fund, a major component of the ESM reform. The backstop arrangements are fully agreed, and moving towards ratification could be the next concrete step in strengthening the financial backbone of banking union.

Looking further ahead, broader issues need to be resolved, which have not yet matured to the same degree – particularly the introduction of a common European deposit insurance scheme.

Due to past supervisory measures, banks were much better prepared to weather the current crisis. But we do not yet know the ultimate impact of the crisis on bank balance sheets, because the economic outlook remains very uncertain. Completing the financial pillar of banking union will prevent the use of taxpayer money to resolve failing banks, and help break the sovereign-bank doom loop that was particularly harmful to the euro area during the financial and sovereign debt crisis.

The creation of a capital markets union is another political initiative with particular relevance for the euro area. It aims to integrate all 27 national financial markets, facilitate cross-border investments, and open up new ways of financing for companies.

Banking credit and more capital market finance can support the recovery everywhere. For the euro area, it matters particularly because it adds to more private sector risk sharing and helps to make monetary union work better. The existence of a single supervisor and a single central bank in our common currency area offers opportunities here. The euro area can offer a single infrastructure to capital markets – the ECB is doing this in many areas, such as payments. Moreover, the single supervisor has forceful mechanisms to avoid regulatory arbitrage and create a level playing field. Pushing ahead with banking union and capital market union will help make the euro more attractive to international investors.

Finally, increasing the volume of euro-denominated safe assets will improve the euro area’s financial stability and economic resilience, and also support a common monetary policy.

A larger pool of euro safe assets would allow Europe’s banks to diversify their sovereign debt portfolio, and attract international capital to Europe. These are crucial elements in enhancing the stabilisation and convergence properties of the euro area.

The volume of debt issued by the European Commission, the European Investment Bank, and the ESM as part of the pandemic response will increase European safe assets from today’s €800 billion to almost €2 trillion.

Together with the sovereign debt of the top-rated euro area countries, euro safe assets would then amount to around 40% of euro area GDP.

II. Implementing the euro area agenda

Agreeing and implementing the European and the euro area agenda will be demanding. The Euro Summit and the Eurogroup will continue to play an important role, given the distinct needs of euro area member states.

The Eurogroup in particular remains an important forum for European finance ministers to exchange views, forge a high-level political consensus, and take initiatives on vital issues. The Eurogroup has a successful track record of fostering necessary agreements.

Eurogroup President Paschal Donohoe recently noted euro area members' "willingness towards a coordinated approach on budgetary policy and for using the Eurogroup as a forum to reach this understanding."

. Given its importance, the Eurogroup has rightly become more transparent. The Presidency now publishes the agenda, documents, and summary minutes as well as holding press conferences after meetings.

It is the appropriate vehicle to discuss and push forward he next set of improvements on the euro area agenda.

At the same time, it is clear that many decisions and implementation steps will necessarily follow European decision-making procedures.

This is the only way forward for any measure that falls under EU competencies and provides a safe decision-making and implementation framework.

During the past decade, we saw that it was not possible, for political and legal reasons, to follow European procedures.

Member States instead embarked on an intergovernmental framework to deepen monetary union – most prominently with the creation of the ESM.

But it was always clear that the scope for these intergovernmental measures is limited in Europe and constrained by the competencies that Member States have given to the EU.

The political process in euro area summits and in the Eurogroup will therefore complement European procedures.

Which of these two decision-making strings will carry the most political weight depends on the specific agenda item and envisaged institutional policy response.

The sovereign debt crisis resulted in a quantum leap in euro area integration. The Covid-19 pandemic, with the Recovery and Resilience Fund, has resulted in a similar quantum leap in European integration.

For a successful recovery, we must make progress with the EMU deepening agenda in parallel with the implementation of the programmes linked to the Recovery Fund.

That is why EU and euro area agendas are complementary.

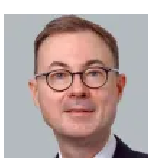
Thank you!

References:
Pierre Werner (1969), "Strengthening the European Communities"

Author

Rolf Strauch
Chief Economist and Management Board Member

Contacts



Cédric Crelo
Head of Communications and Chief Spokesperson
+352 260 962 205
c.crelo@esm.europa.eu

Anabela Reis
Deputy Head of Communications and Deputy Chief Spokesperson
+352 260 962 551
a.reis@esm.europa.eu

Juliana Dahl
Principal Speechwriter and Principal Spokesperson
+352 260 962 654
j.dahl@esm.europa.eu