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Reasons to be optimistic about the EMU's resilience and future

By Regling Klaus - Managing Director, European Stability Mechanism

We often come across pessimistic views about the EU, EMU and the challenges ahead. Low growth, high unemployment, weak banks with high non-performing loans (NPLs) and low profitability, rising populism, discontent with elites and Brussels, and Brexit inform some of the pessimistic views. Is this pessimism always justified?

The positive developments in the EU and the EMU, their future and resilience often go unnoticed. For instance, growth rates are above potential and the output gap is being closed. In line with past trends, GDP-per-capita growth is again similar to that of the United States. Income is spread across society much more equally in Europe than in the US. A much larger share of the population has experienced real income gains during the last 15 years in Europe than in the US. The European labour market is another unexpected strong point. Employment and participation rates are higher than in 2000, while in the US they have dropped. Considering banks, capital for European banks has doubled by more than €500 billion since 2008. NPLs are high but 52% of these are provisioned.

Positive developments also relate to the creation of new and well-functioning institutions during the crisis such as the SSM, the SRF, SRB, ESRB and the ESM. They make the EMU more resilient. Within the euro area, macroeconomic imbalances have significantly decreased over the last few years and economic policy coordination among the Member States has become much broader.

Another positive element is the continuous support for the EU and the euro among citizens. According to the latest surveys, support for the EU and euro is well over two thirds of citizens in the euro area. In the immediate aftermath of the UK referendum, public opinion polls in a number of euro area countries showed that support for EU membership rose significantly. Such support gives policy-makers a mandate to continue with further integration steps in certain areas.

However, an unqualified call for more Europe cannot be the answer. A European approach is appropriate only when a certain objective can be better achieved by working together across countries. If that is not the case, then a policy area should be dealt with on a level closer to the citizens.

Applying these criteria to the EMU, two important steps make the EMU more robust. They can be brought under the heading of stronger risk-sharing, which is under-developed in the euro area compared with the US and compared with large European economies. Risk-sharing can be done through capital markets and through the fiscal channel.

In that context, more work needs to be done on the Capital Markets Union to facilitate and strengthen cross-border capital flows. Completing Banking Union is equally important, including a European Deposit Insurance Scheme (EDIS). The latter is controversial because the current systems in the euro area countries are different, cannot be merged overnight, and need to be made more comparable first. Some countries also need to reduce the legacy burdens of their banks (“de-risking”). Still, after a transition period, EDIS would make the currency union less vulnerable.

With respect to the fiscal channel, it could be useful to establish a limited budgetary capacity for the euro area. EMU does not have such a fiscal capacity that can be used in case of asymmetric economic shocks in some countries. A fiscal capacity that does not lead to permanent transfers or a mutualisation of debt would improve the functioning of the currency union. Comparable instruments exist in the US, where states can tap so-called rainy day funds.

In sum, there are good reasons to be optimistic about EMU’s resilience and future. Europe has made good progress and public support remains strong. It is worth reminding how far and rapidly the EU and the EMU have come. This should give the confidence needed to tackle a few, very specific challenges, particularly in areas where objectives can be better achieved by working together across countries.

Author

Klaus Regling

Managing Director

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