



# Governance, European Integration and Macroeconomic Policies

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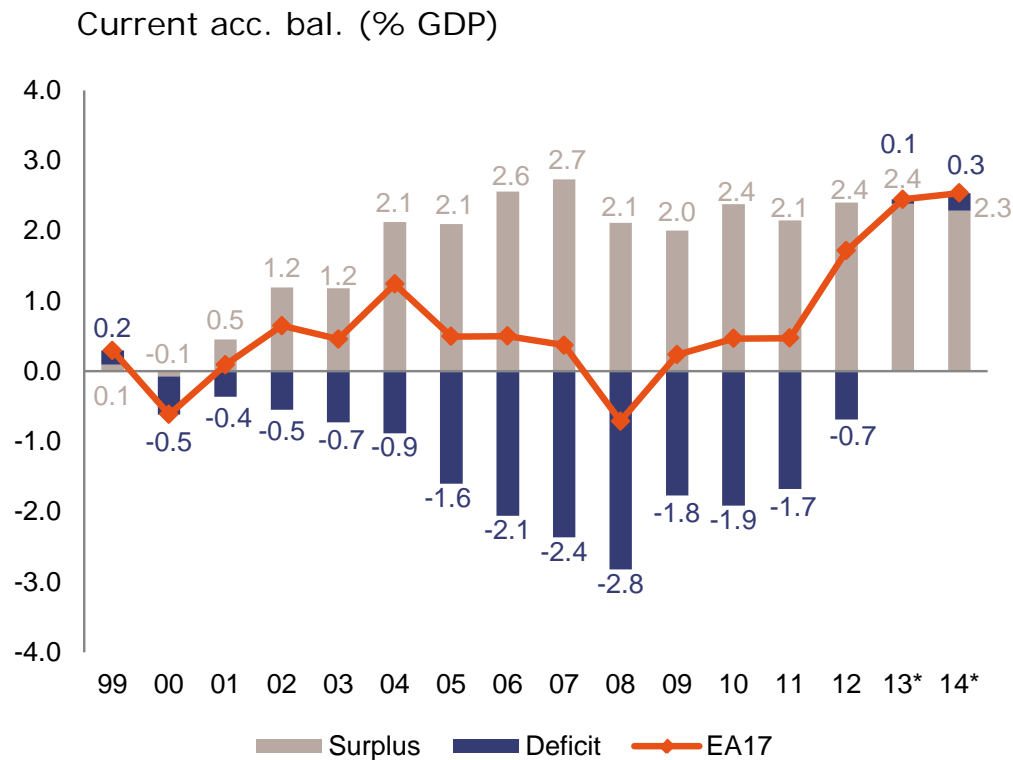
Scuola Superiore de la Pubblica Amministrazione, September 17, 2013

# Lessons from the crisis

- *Market and policy failures in pre-crisis years*
  - Build-up of large macroeconomic imbalances (e.g. EC 2008, 2010, Lane 2013, Obstfeld 2013)
    - Sectoral and geographical concentration of risks
    - Capital inflows into the periphery diverted from productive uses
    - Distortions in production structure (tradable/non-tradable sectors)
    - Large divergences in external competitiveness
  - Insufficient fiscal consolidation in the good times (e.g. EC 2009, Lane 2012, Obstfeld 2013, Wyplosz 2013)
  - No TINA effect: lack of structural reforms to cope with asymmetric shocks (e.g. EC 2008, OECD)

# Lessons from the crisis

- Market and policy failures (I) External imbalances*

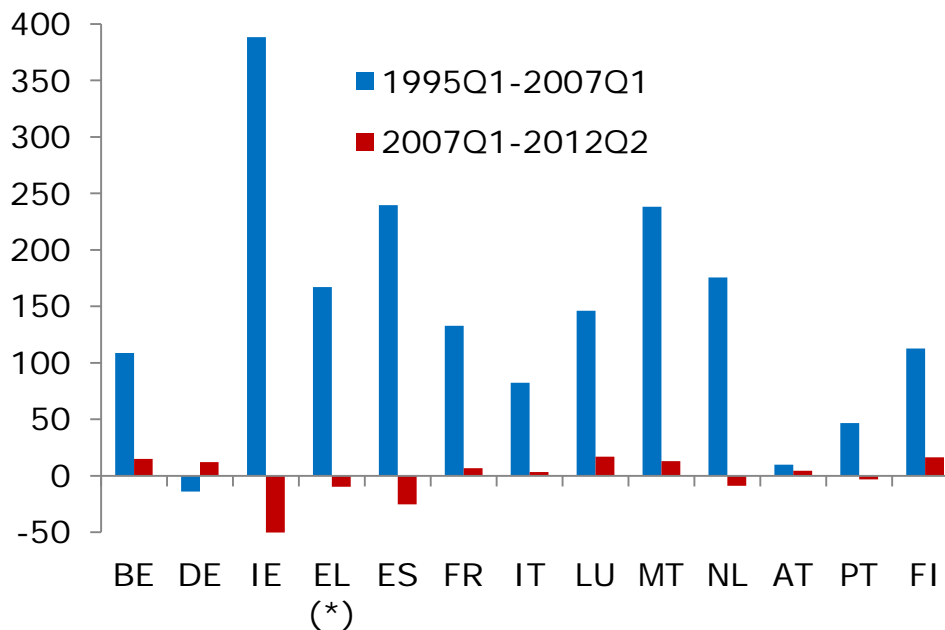


Note: The definition of surplus / deficit countries is based on the average current account balance in the 1999-2007 period. Surplus countries: BE, DE, LU, NL, AT, FI; Deficit countries: IE, EL, ES, FR, IT, CY, MT, PT, SI, SK

# Lessons from the crisis

- Market and policy failures (II) – Housing imbalances*

Change in nominal house prices (%)

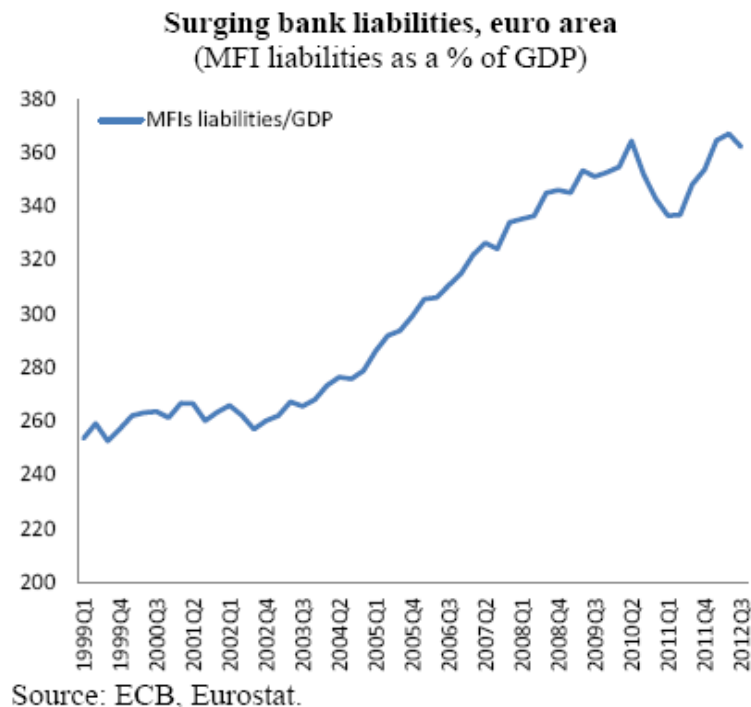


(\*) For Greece, 1997Q1-2007Q1

Source: OECD, STAT, ECB

# Lessons from the crisis

- *Rapid financial deepening magnified the impact of market and policy failures*
  - EMU pre-crisis architecture built around fiscal and price stability
  - Financial dimension of macroeconomic stability largely overlooked

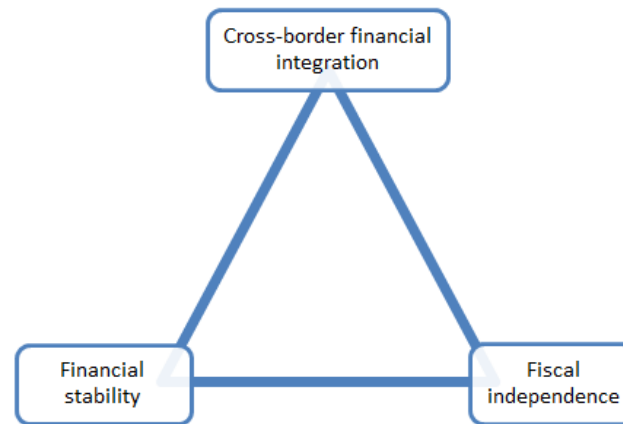


# Lessons from the crisis

- **Financial vulnerabilities revealed by the crisis**

- Strong cross-border financial contagion effects (Forbes 2012, Constancio 2012)
- Internal financial market threatened by market fragmentation (e.g. Pagano 2013, Schoenmaker 2013)
- Sudden stops, multiple equilibria and sovereign / bank doom loop more likely in EA (e.g. Lane 2013, De Grauwe 2013, Obstfeld 2013)
- Banks too big to fail and too big to save (Obstfeld 2013)
- New policy trilemmas (Obstfeld 2013, Pisani-Ferry 2012)

## A new policy trilemma for the euro area



Source: Obstfeld, 2013

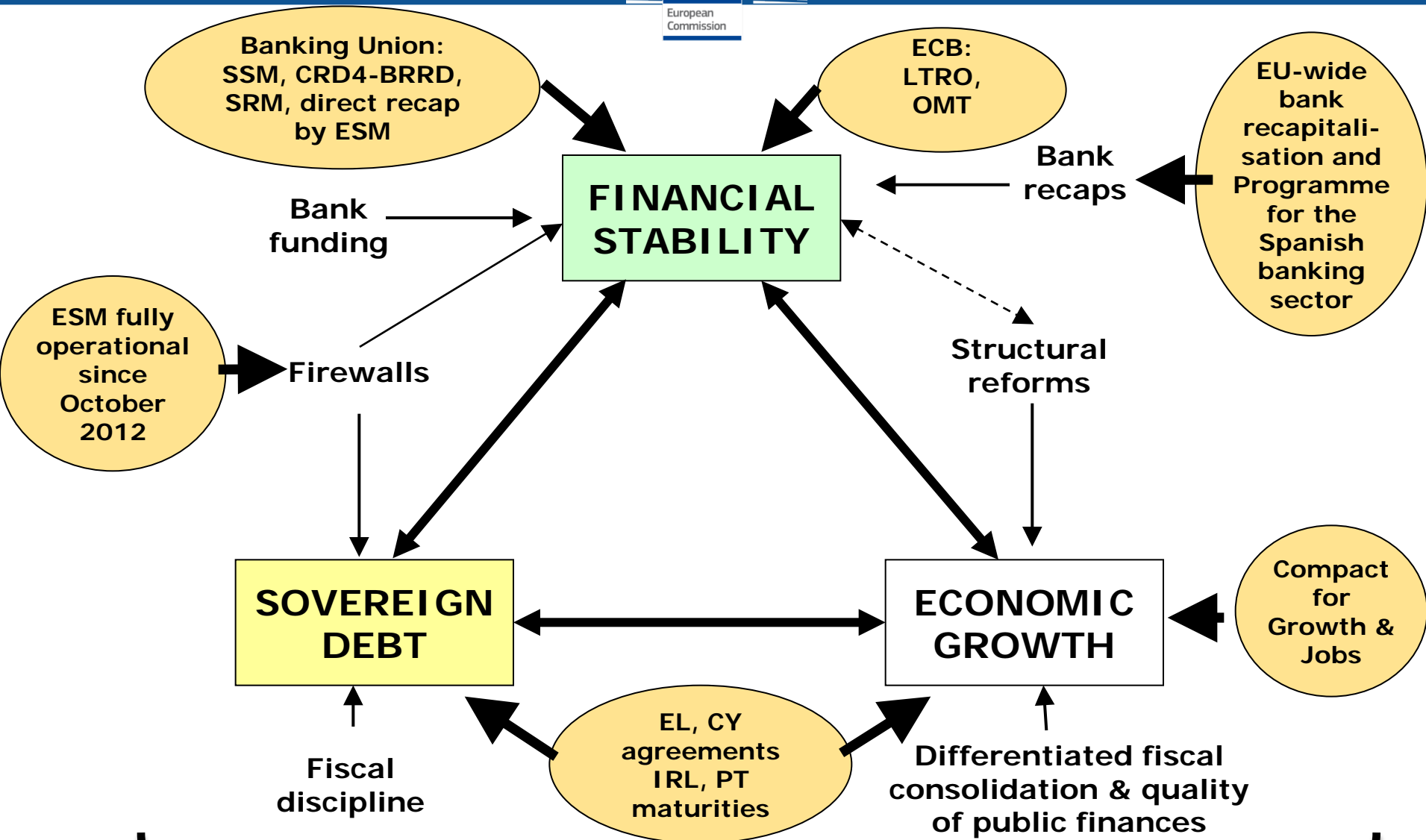
# Gaps in the EMU architecture exposed by the crisis

- ***Excessive risk-accumulation*** in quiet/good times in both the public and private sectors
  - Failing market discipline
  - Insufficient monitoring and enforcement tools

➡ Need to improve risk prevention

- ***Risks of financial instability*** within the single currency :
  - Contagion between fragile sovereigns
  - Feedback loops between weak fiscal and financial sectors
  - Financial fragmentation across the euro area, even threatening the integrity of the euro area

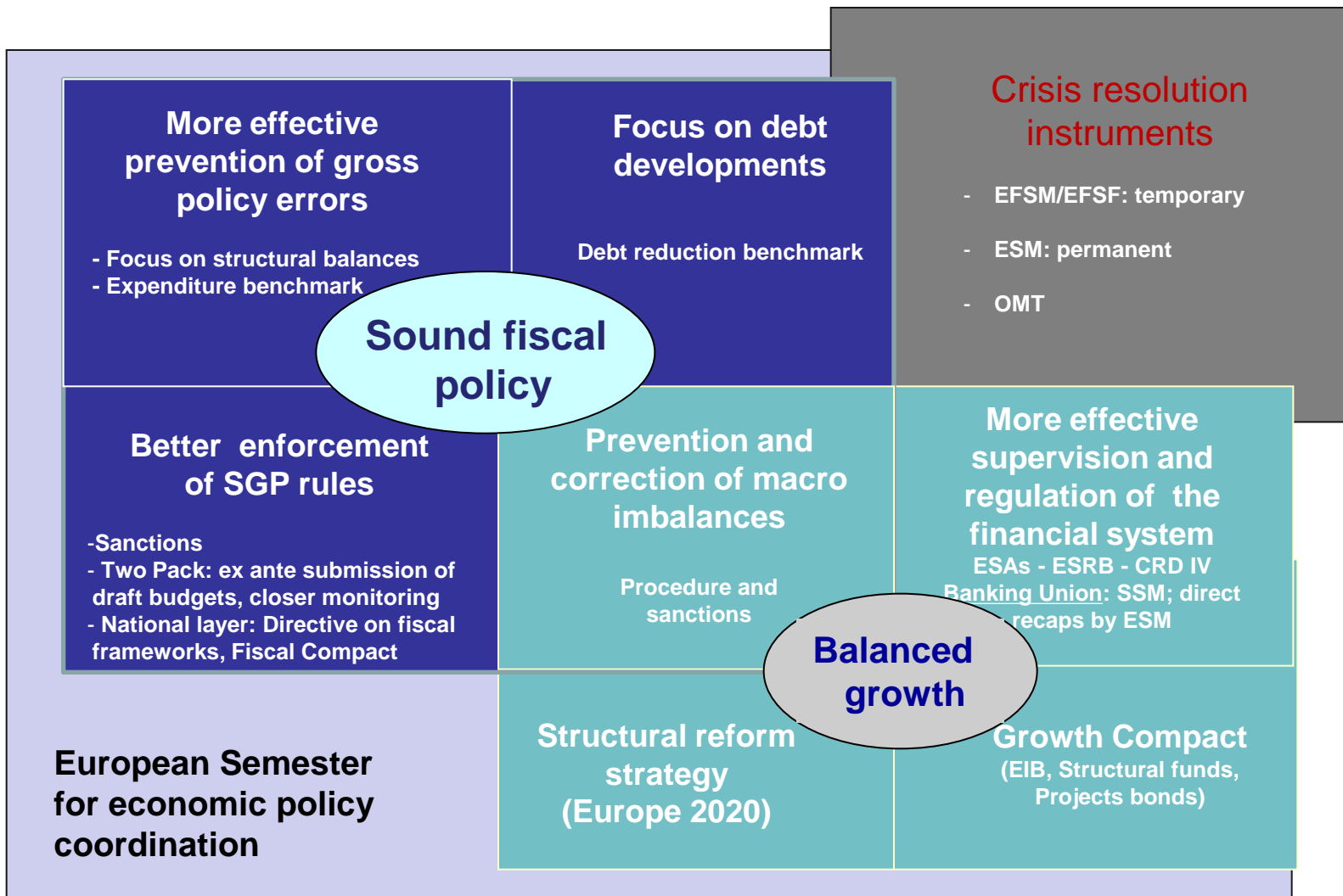
➡ Need to improve crisis resolution



**Towards a fiscal & economic union –  
what has been achieved so far**



# Changing EMU governance: implementation of the six-pack and comprehensive crisis management response



# Two pack : A new cycle of surveillance in the euro area

## Autumn

Presentation of draft budgetary plan for following year

- COM Opinion
- Assessment of the EA policy stance
- Discussion by Eurogroup

## End of Year

Budget Law

## European Semester – Spring

Presentation of medium-term fiscal and economic policy plans (Stability Programmes and NRPs for the medium-term)

- Assessment of compliance with preventive arm of SGP (structural balance + expenditure benchmark)
  - *Ex ante* for in-year and following years
  - *Ex post* for previous year
- Macroeconomic surveillance
- Policy guidance and recommendation

# Changes in EMU governance: why and how to go further?

- Further integration needed to address the weak spots underlined by the crisis.
- The Commission's blueprint for deepening EMU: A stage-based process around 4 pillars:
  - Complete financial integration: a genuine banking union
  - Develop gradually a central 'fiscal capacity'
  - Strengthen economic union and reforms
  - Take commensurate changes in political accountability
- A condition: keep a balance: stronger intrusiveness matched by common instruments to manage shared challenges.

# Bridging different positions

Solidarity



Discipline

Short-term  
response



Long term reform

Discretion



Rules

Demand  
(cyclical/macro)



Supply (potential  
growth struct. ref.)

Maintaining  
sovereignty



Political Union

All MS (symmetric  
adjustment)



Only vulnerable  
MS  
(asymmetric  
adjustment)

Secondary law



Treaty changes

Community  
framework



Inter-  
governmental

Euro Area



European Union

# The Commission Blueprint for a deep and genuine EMU

## → Principles:

- **A comprehensive approach:** financial, fiscal, economic and political architecture. Economic, legal, and institutional aspects.
- **A gradual approach:**
  - short, medium and long term actions
- **A balanced approach:**
  - Discipline and solidarity
  - National and EA responsibilities
- **A Treaty-based approach:**
  - deepening of EMU to be based on Treaty framework
  - Euro area must be able to integrate quicker (Art. 136 TFEU)
  - Treaty changes to be resorted to when indispensable

# **The Commission Blueprint**

## **The short term (6-18 months)**

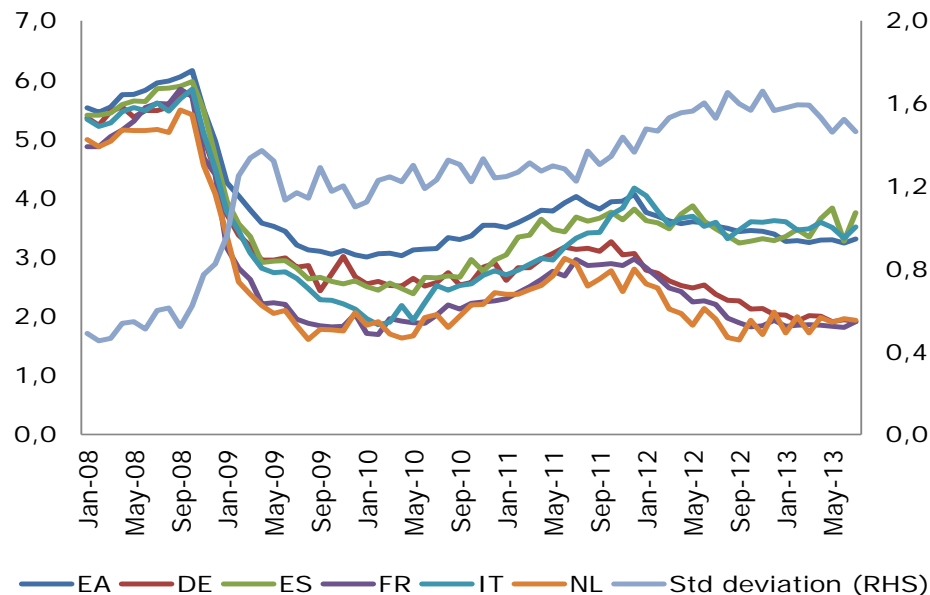
- **Banking Union: a Single Resolution Mechanism matching the Single Supervisory Mechanism.**
- **Full deployment of on-going comprehensive response ('Six-Pack'; 'Two-Pack').**
- **Ex-ante coordination of and incentives for major structural reforms.**

# A genuine banking union is a priority

## Banking Union needed to address:

- Financial fragmentation
- Negative feedback loop between sovereigns and banks
- Financial stability, restore confidence and underpin recovery

Interest rates on loans to non-financial corporations



# A genuine banking union is a priority

## A fully-fledged Banking Union must comprise:

- Single Supervisory Mechanism (SSM)
- Single Resolution Mechanism (SRM) with a resolution fund
- A credible fiscal backstop to cover residual risks and provide bridge financing when needed
- Precondition for the introduction of potential direct recapitalisation of banks by ESM



# Completing banking union

## *SRM proposal*

- Sep '12: COM adoption
- Dec '12: ECOFIN general approach
- March '13: Political agreement
- Mid-2014: SSM phase-in completed

- **Legislative proposals: mid 2013**
- **Elements:**
  - **Independent resolution authority**
  - **Adequate financing arrangements**

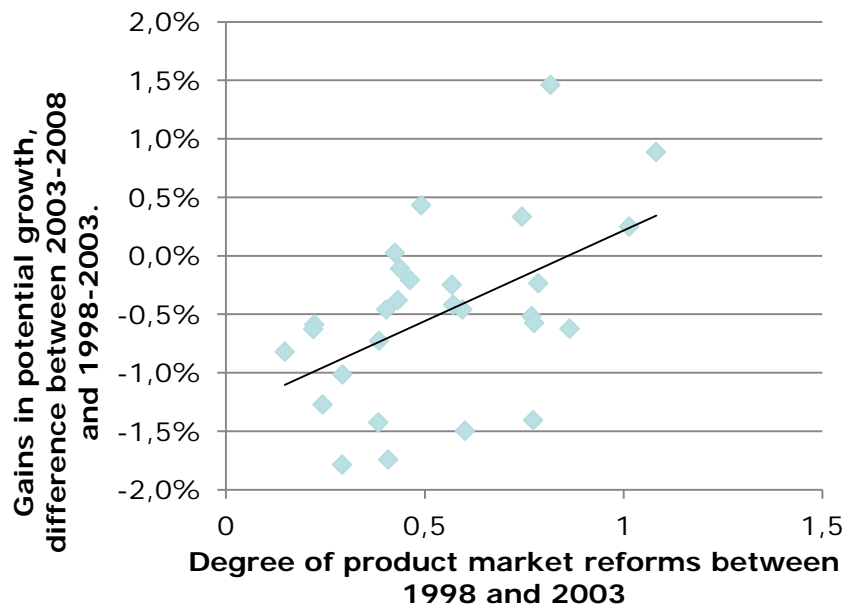
**Single Supervisory  
Mechanism –**  
Effective supervision,  
based on high  
common standards

**Single Resolution  
Mechanism –**  
Effective crisis  
resolution, private  
sector funding

***Single Rulebook for EU 27***

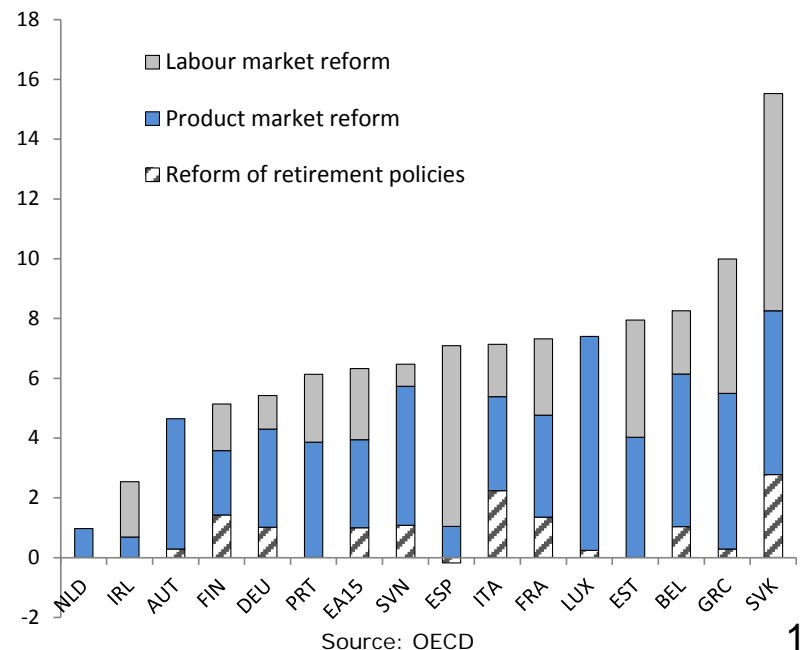
# Structural reforms

- Structural reforms needed to boost growth and facilitate rebalancing
- Vulnerable countries have made significant progress, but more is needed to spur external competitiveness.
- Less progress in core countries, product market reforms needed to improve competition and strengthen domestic demand
- Although reforms are a MS responsibility, EA architecture can help (ex-ante coordination of and incentives for reform)



Source: OECD

Difference in the level of GDP in 2025, (%)



Source: OECD

# Ex ante coordination and CCI

## **Aim ?**

*To allow for an EU-level assessment and discussion of the most important plans for major economic policy reforms before final decisions are taken at the national level. (Article 11 of the Treaty on Stability, Coordination and Governance)*

## **Rationale ?**

*Major economic reforms at the national level can have an important impact on the functioning of EMU and direct economic effects on other Member States. Also: mutual learning.*

## **CCI => Financial incentives**

*Support the implementation of flanking measures to facilitate the implementation of the reforms covered in the contractual arrangement by means of a mechanism of regular installments following implementation of the contractual arrangements*

# The Commission Blueprint

## The medium term (18 months to 5 years)

- **Greater control of national budgetary policies:**  
a European collective control over national budgetary policy in defined situations, investigate ways to strengthen the fiscal automatic stabilisers
- **Scaling up the Convergence and Competitiveness Instrument:** a Euro area fiscal capacity, including borrowing
- **Towards conditional steps in debt mutualisation:**
  - European Redemption Fund → tackling legacy debt
  - Eurobills → financial market efficiency, conduct of monetary policy

## The Commission Blueprint for a deep and genuine EMU—The long term (beyond 5 years)

- **A full banking union:** supervision, resolution but also joint deposit insurance
- **An EMU cyclical stabilisation instrument:**
  - for asymmetric shocks only  
or
  - including symmetric shocks (implying borrowing)
- **Common public debt:** mutualisation goes hand in hand with deep sovereignty sharing

# Conclusions

- Very significant steps taken and under way
- Balanced approach for substantive reasons and political feasibility
- Better functioning of EMU not beyond reach
- Envisaged reforms go to the very heart of sovereignty

➡ Time, patience and political maturation needed on a likely bumpy road.

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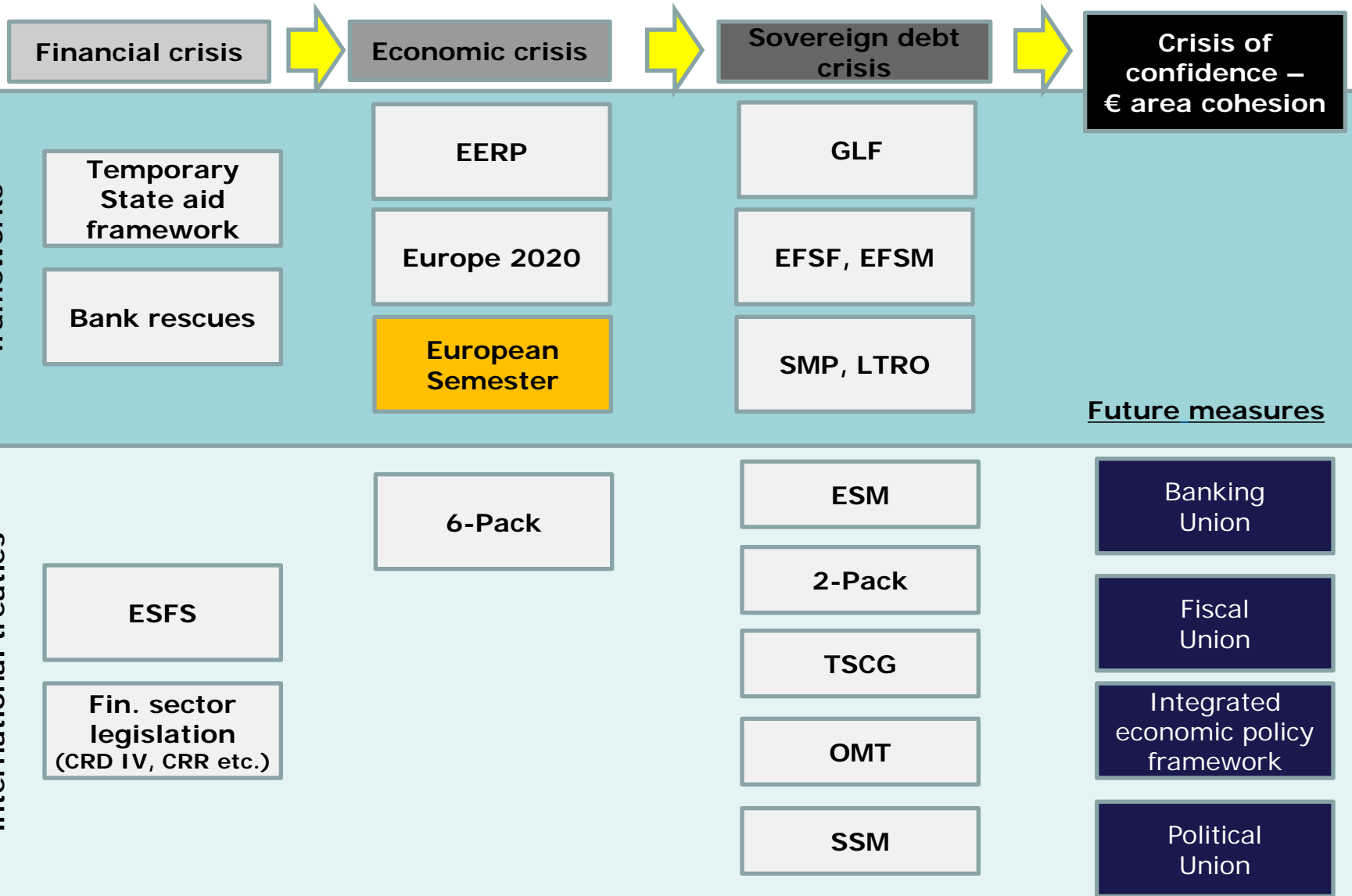




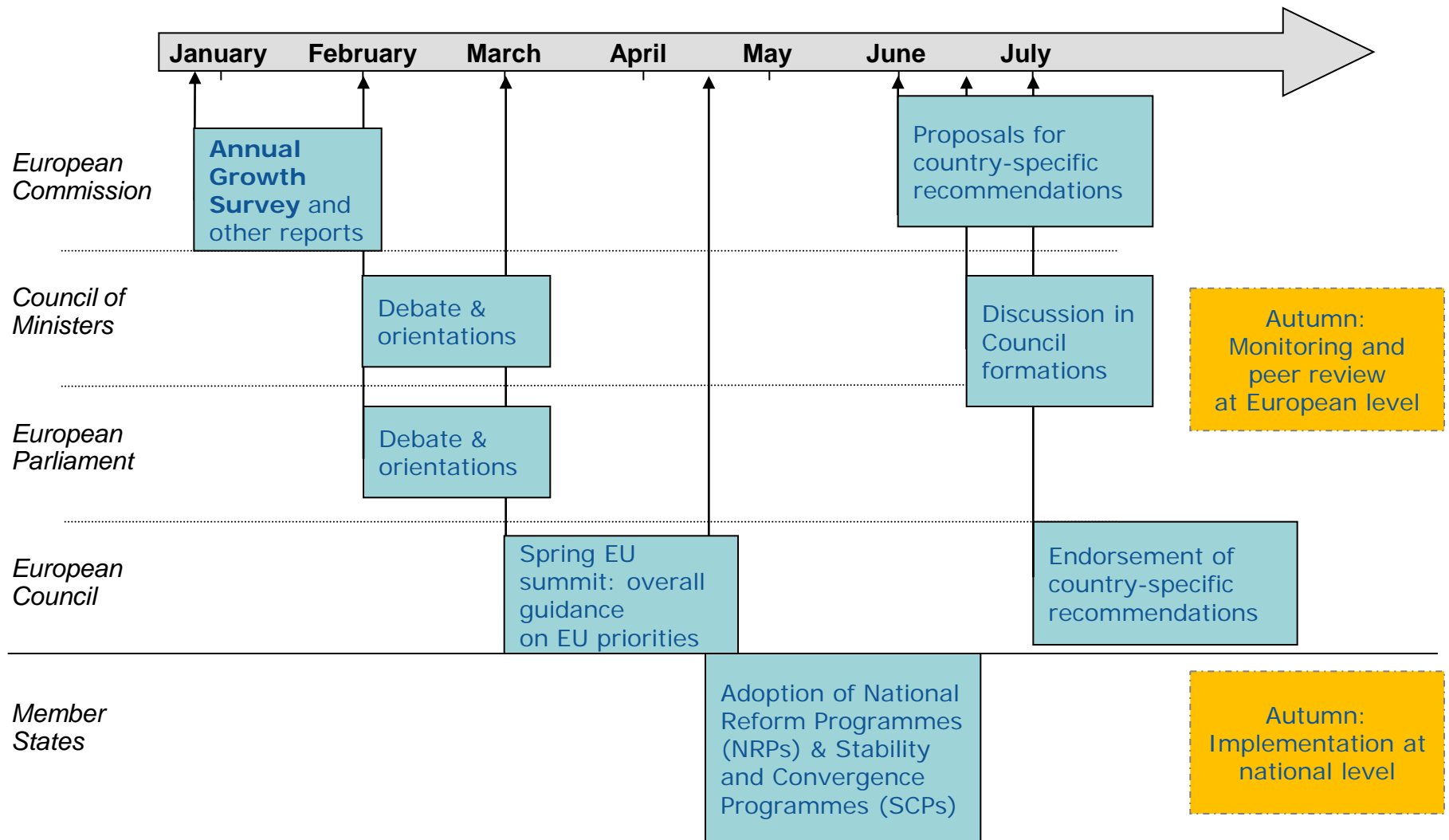
**Thank you!**

# Bonus material

# Measures to tackle the crisis



# Full deployment of on-going comprehensive response: *Implementation of the EU semester*



# The 2013 AGS priorities

The Commission therefore considers that the EU should focus on the same priorities as in last year's AGS:

- Pursuing differentiated, growth-friendly fiscal consolidation
- Restoring normal lending to the economy
- Promoting growth and competitiveness for today and tomorrow
- Tackling unemployment and the social consequences of the crisis
- Modernising public administration

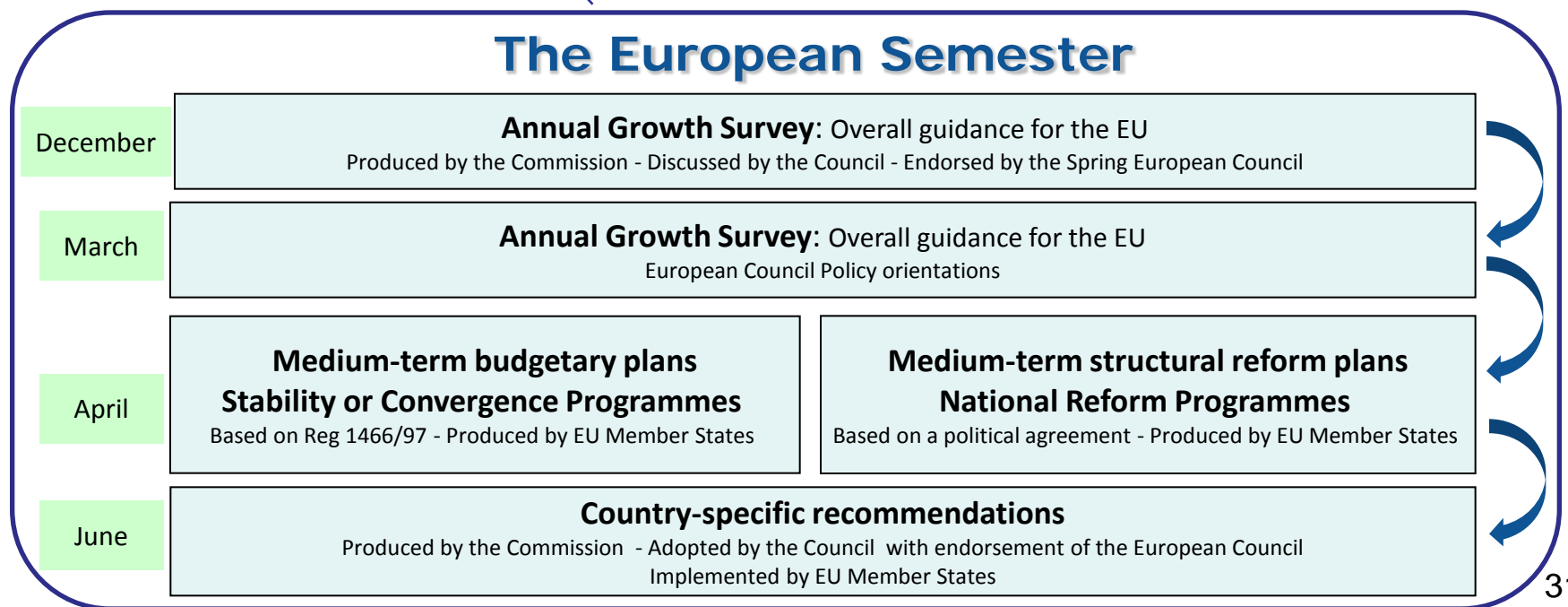
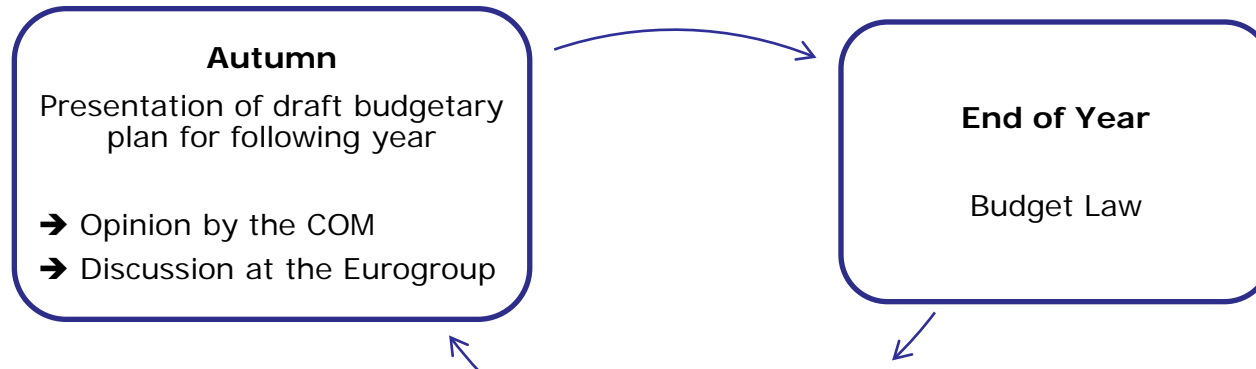
Efforts should be concentrated on implementation

# EU recommendations for national action in 2013/14

	Public finances				Financial sector		Structural reforms					Employment and social policies					
	Sound public finances	Pension and healthcare systems	Fiscal framework	Taxation	Banking and access to finance	Housing market	Network industries	Competition in service sector	Public administration and smart regulation	R&D and innovation	Resource efficiency	Labour market participation	Active labour market policy	Wage setting mechanisms	Labour market segmentation	Education	Poverty and social inclusion
AT																	
BE																	
BG																	
CZ																	
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For Cyprus, Ireland, Greece and Portugal the only recommendation is to implement commitments under EU/IMF financial assistance programmes.

## *Two pack: the new fiscal governance framework in the euro area*



# Two pack: COM Opinions on draft budgetary plans

## Rationale/lessons learned

Need to better integrate EU policy guidance in national budgetary preparations

*Need to equip national Parliaments with an independent assessment*

*Need to assess euro area fiscal stance as a whole*



## Innovations

National draft budgetary plans submitted before 15 October to

### ➤ COMMISSION

Poss. request for revision of draft if serious breach of European rules (*within 2 weeks*)

Opinion on the plan (can be + or -) to inform the national debate on the budget → not binding (*before end-November*)

Overall assessment at the level of the euro area

### ➤ EUROGROUP

Discussion based on COM Opinions and overall assessment



# Two pack: Improving national budgetary frameworks

## Rationale/lessons learned

Need to improve compliance with budgetary rules and transparency



## Innovations

Independent bodies at national level

*National fiscal rules to strengthen ownership*



Monitoring national fiscal rules

- Including rules implementing MTO at national level
- By providing assessments linked to automatic correction mechanism

*Need for more reliable forecasts*



Providing macroeconomic forecasts



"And what would you like the forecast to be?"

# Two pack: tighter surveillance of EDPs

## Rationale/lessons learned

## Innovations

Need to better follow the correction implemented by Member States



Closer monitoring for Member States in Excessive Deficit Procedure (EDP)

*Need for additional information flows from Member States to the Commission*



- **OPENING OF EDP**  
Comprehensive reporting on budgetary execution  
[If not in EIP]: Economic partnership programme  
structural measures/reforms instrumental to an effective and durable correction of ED
- **REGULARLY** (every 3 or 6 months)  
Report on budgetary execution and measures taken
- **ON REQUEST by the Commission**  
Audit of public accounts  
Any other information

*Need to be able to react in case of risk of non-compliance with the deadline*



→ **If risks on non-compliance:** additional Commission recommendations

# Ex ante coordination of plans for major economic policy reforms

## Which reforms?

- Only the most important, large reforms => Reforms that:
  - ✓ are relevant for the functioning of EMU
  - ✓ may have economic spillover effects on other Member States
  - ✓ are relevant from a macroeconomic point of view
  - ✓ address, in particular, competitiveness, employment, market functioning, tax systems, financial stability and long-term fiscal sustainability.

## Link with the European Semester

- Major reform plans are reported in the National Reform Programmes. They are likely to be linked to the implementation of country-specific recommendations.
- Ex ante coordination involves a Commission opinion and discussion in the Eurogroup and the Council. These will be taken into account in the next assessment process of the Semester, culminating in the Country-Specific Recommendations.
- However, if a major reform plan is designed at another time of the year, the ex ante coordination will take place at that moment so that the result can be taken into account before the reform is adopted.

## Objectives of the Single Supervisory Mechanism

Ensure that **all banks are subject to supervision of the highest quality**, implement a **single rule book** and common supervision standards

**ECB able to look also at smaller banks** which may pose risks for financial stability. Evidence has shown they may pose as systemic (Cajas)

**Good balance of tasks distribution** between national supervisors and the ECB

Governance structure will be adjusted

The **Role of EBA will be preserved**

SSM is expected to be fully in place **by July 2014**