



COMPLETING EUROPE'S EMU – WHERE DO WE STAND?

Background for presentation by Niels Thygesen*
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IN WHAT SENSE IS EMU "INCOMPLETE"?

WAS THE CONSTRUCTION FAULTY FROM THE START, NOTABLY BY FOCUSING NARROWLY ON MONETARY UNIFICATION?

OR WAS A FUNDAMENTALLY VIABLE CONSTRUCTION UNDERMINED BY DIVERGENT NATIONAL POLICIES?

AS A CONTRIBUTOR TO THE EARLY DESIGN I HAVE A BIAS IN FAVOUR OF THE SECOND INTERPRETATION

SO LET ME START BY REEXAMINING THE NATURE OF THE FRANCO-GERMAN COMPROMISE ON EMU REACHED AT MAASTRICHT, ONLY SEVEN YEARS BEFORE THE START OF EMU



THE TWO MAIN ECONOMIC ARGUMENTS IN FAVOUR OF EMU:

- A LOGICAL FOLLOW-UP TO THE SINGLE INTERNAL MARKET PROGRAMME FOR 1992, UNLIKELY TO HAVE OCCURED WITHOUT ELIMINATION OF THE REMAINING EXCHANGE-RATE RISKS IN THE EMS
- THE DESIRE TO DEFEND EUROPE BETTER AGAINST MAJOR EXTERNAL DISTURBANCES FROM ENERGY PRICES AND THE US DOLLAR, BOTH OF WHICH HAD BEEN DRAMATIC OVER THE PERIOD OF THE 1970s AND 80s

THESE TWO ARGUMENTS WERE GENERALLY ACCEPTED BY ALL (THEN) 12 MEMBER STATES – AND PUSHED BY THE EUROPEAN BUSINESS SECTOR



TWO OTHER ARGUMENTS FACILITATED GERMAN ACCEPTANCE OF SHARED MONETARY AUTHORITY :

- INCREASING MOBILITY OF CAPITAL WAS MAKING THE EMS LESS MANAGEABLE, AND WHEN OTHER EMS COUNTRIES IN 1988 CEDED TO THE GERMAN PUSH TO REMOVE ALL REMAINING CONTROLS ON SHORT-TERM CAPITAL FLOWS, THE ARGUMENT TO MOVE TO A SINGLE CURRENCY STRENGTHENED
- GERMANY HAD, BY THE LATE 1980s, GROWN TIRED OF BEING (WITH JAPAN) A WHIPPING BOY FOR A DOMINANT, THOUGH UNSTABLE, US IN THE MEETINGS OF THE G7 AND OTHER GLOBAL FORA - AND MORE READY TO SHARE THE ROLE OF EUROPEAN SPOKESMAN WITH OTHERS



HENCE, WHEN FRANCE, SECONDED BY ITALY, BEGAN TO PUSH FOR EMU IN 1988, GERMAN (AND DUTCH) SCEPTICISM TOWARDS THE IDEA COULD BE OVERCOME, SUBJECT TO A COMPROMISE BETWEEN TWO INSTINCTIVE NATIONAL INTERPRETATIONS IN GERMANY AND FRANCE

- IN *GERMANY* THE MAIN PURPOSE OF EMU WAS SEEN AS THE LOCKING-IN OF LOW AND STABLE INFLATION – EXPORTING GERMAN “STABILITÄTSKULTUR”, WHILE
- IN *FRANCE* “SHARING OF MONETARY LEADERSHIP” WITH GERMANY/THE BUNDESBANK WAS PRESENTED AS THE MAJOR PURPOSE - ONE THAT COULD NOT BE REACHED BY FRANCE BILATERALLY



EMU, AS AGREED AT MAASTRICHT, DOES EMBODY THESE TWO PERSPECTIVES, THOUGH A TENDENCY REMAINED FOR NEARLY TWO DECADES (UNTIL 2008) TO EMPHASIZE ONLY ONE OF THEM TO THE PUBLIC IN GERMANY AND FRANCE AND IN THE COUNTRIES "ALLIED" TO ONE OR THE OTHER – CREDITORS VS. DEBTORS, CORE VS. "PERIPHERY"

THE DIFFERENCE OF PERSPECTIVE IS MOST ACUTE, NOT IN THE MONETARY AREA, BUT IN THE VIEW ON THE MAIN PRINCIPLE FOR FISCAL POLICIES TO UNDERPIN MONETARY UNION: SHOULD THEY BE DIRECTED AT RULES FOR CONTAINING INDIVIDUAL COUNTRY BEHAVIOUR OR AT FINDING AN "APPROPRIATE" AGGREGATE FISCAL STANCE FOR EMU AS A WHOLE? CAN THE TWO BE RECONCILED?



ON THIS POINT, THE EMU FRAMEWORK LEANED CLEARLY TOWARDS THE GERMAN RULES-BASED PERSPECTIVE, THOUGH WITH SOME BLUNTING AT THE EDGES – ENFORCEMENT HAS NEVER BECOME AS AUTOMATIC AS PROPOSED BY GERMANY, INDEED IT BECAME FAR WEAKER THAN ANTICIPATED,

BUT VESTING DISCRETIONARY AUTHORITY AT THE LEVEL OF THE ECOFIN COUNCIL TO “COORDINATE” NATIONAL FISCAL POLICIES AND ADJUST THE POLICY MIX WITH THE ECB, AS FRANCE (AND ITALY) HAD ADVOCATED, COMPLETELY DISAPPEARED IN THE TREATY

BETWEEN THE POSITIVE, BUT FUDGED, MENTION OF “POLICY COORDINATION” IN THE DELORS REPORT OF 1989 AND PRESIDENT DRAGHI’S JACKSON HOLE SPEECH OF 2014, NO EXPLICIT POLICY STATEMENT BY MAJOR EMU OFFICIALS ADVOCATED COORDINATION



THE FIVE PRESIDENTS' REPORT OF JUNE 2015 REPEATS THE BASIC MESSAGE OF PRESIDENT DRAGHI:

"Responsible national fiscal policies are therefore essential. They must perform a double function: Guaranteeing that public debt is sustainable and ensuring that fiscal automatic stabilisers can operate... but this is not enough. It is important to ensure also that the sum of national budget balances leads to an appropriate fiscal stance at the level of the euro area as a whole..."

IN SHORT, FISCAL POLICY SHALL ASSURE BOTH SUSTAINABILITY AND STABILIZATION FUNCTIONS (FROM STAGE 2) AND THIS SEEMS TO ME THE MAIN NEW MACROECONOMIC ELEMENT IN THE REPORT, AND COULD BE PREPARED BY THE PROPOSED ADVISORY FISCAL BOARD IN STAGE 1



OF COURSE EMU IS INCOMPLETE IN OTHER WAYS THAN BY EMBODYING A SPECIFIC VIEW OF FISCAL POLICY, BUT THIS IS THE MOST CONTROVERSIAL ASPECT

THIS REVISED VIEW ENTAILS A SHIFT IN THE RESPONSIBILITIES OF THE MONETARY AND THE FISCAL/POLITICAL AUTHORITIES

THE MAASTRICHT TREATY HAD DESIGNED THE ECB AS THE ONLY EUROPEAN AUTHORITY WITH A POLICY RESPONSIBILITY AT THE AGGREGATE LEVEL –AND ONLY THAT - AND THE ECB HAS COMPLIED WITH BOTH IN ITS OMT ANNOUNCEMENT AND IN THE 2015-16 QE

NOW THE FISCAL AUTHORITIES ARE ALSO TO HAVE AN AGGREGATE RESPONSIBILITY, HOWEVER DIFFICULT TO IMPLEMENT



THREE AREAS WHERE EMU NEEDS DEEPENING

WHILE THE BASIC DESIGN OF EMU WAS FOCUSED ON MONETARY POLICY, ITS INSTITUTIONS AND MINIMAL UNDERPINNINGS IN OTHER POLICY FIELDS, THREE AREAS AT THE CORE OF EUROPEAN CONCERNS TODAY WERE BY COMMON AGREEMENT BEYOND THE HORIZON 25 YEARS AGO – BUT ALL ARE NOW BEING ELABORATELY ADDRESSED:

- A EUROPEAN RESPONSIBILITY FOR FINANCIAL STABILITY
- A PUBLIC SAFETY NET FOR COUNTRIES IN MAJOR ADJUSTMENT PROGRAMMES
- BETTER LABOUR AND PRODUCT MARKET POLICIES TO IMPROVE THE PROSPECTS FOR ECONOMIC GROWTH AND EMPLOYMENT



FINANCIAL STABILITY

NO RECOGNITION IN 1990 OF A NEED FOR A EUROPEAN ROLE : FEW CROSS-BORDER BANK ACTIVITIES, NO BANKING CRISIS EXPERIENCE

THE FUNDAMENTALS CHANGED WITH THE EURO, WITH THE MASSIVE EXPANSION OF BANK BALANCES, AND WITH THE "VICIOUS CIRCLE" OF INTERACTING BANKS AND SOVEREIGNS FROM 2009-10

MAJOR PROGRESS SINCE 2012 WITH SSM THROUGH THE ECB, AND THE RULES FOR RECOVERY AND RESOLUTION; A JOINT FISCAL BACKSTOP AND DEPOSIT INSURANCE DESIRABLE IN THE LONG RUN, BUT LESS URGENT DUE TO TRANSITION TO BAIL-IN REGIME

BANKING UNION IS THE MAIN SINGLE STEP TO MAKE EMU COMPLETE



A PUBLIC SAFETY NET

THE NEED FOR A SAFETY NET, ACCESSIBLE FOR EMU PARTICIPANTS WHO - DESPITE THE PREVENTIVE RULES ON FISCAL IMBALANCES - LOSE ACCESS TO INTERNATIONAL FINANCIAL MARKETS, WAS SEEN AS UNNECESSARY AND FAR BEYOND THE MAASTRICHT AGENDA

THROUGH CONSTRUCTIVE IMPROVISATION A PERMANENT MECHANISM WITH SUBSTANTIAL RESOURCES – THE ESM – IS NOW AVAILABLE, THOUGH ONLY, AT THE INTERGOVERNMENTAL LEVEL

THE ESM MAY NEED IN THE FUTURE TO ASSUME THE SOLE ROLE IN MANAGING ADJUSTMENT PROGRAMMES AS THE IMF RETREATS INTO AN ADVISORY ROLE AND THE ECB ALSO FADES FROM THE "TROIKA"



"STRUCTURAL" POLICIES

LABOUR AND PRODUCT MARKET POLICIES WERE NOT IN FOCUS AT MAASTRICHT – THE VERY SLOW DEMOGRAPHICS OF EUROPE IN FUTURE DECADES HAD NOT YET BEEN ABSORBED BY POLICY MAKERS

THE "LISBON STRATEGY" OF 2000 MARKED A CHANGE, BUT TOO MANY OBJECTIVES, AND TOO LITTLE NATIONAL INVOLVEMENT

WITH THE EUROPEAN SEMESTER FAR MORE DETAILED MONITORING HAS BEEN SET UP AND THE RELUCTANCE TO "NAME AND SHAME", NOT ONLY TO PRAISE, HAS FADED

THE STRONGER MONITORING OF COMPETITIVENESS IN THE FIVE PRESIDENTS' REPORT IS HIGHLY VALUABLE



CONCLUSIONS

THE MAASTRICHT DESIGN WAS INCOMPLETE, BUT THE COMPROMISE IN THE TREATY COULD WELL HAVE PROVED VIABLE IF NATIONAL GOVERNMENTS HAD NOT IN AN UNPREDICTABLY FLAGRANT WAY VIOLATED ITS CENTRAL PREMISES

IF ONE LEAVES ALL POLICY INSTRUMENTS APART FROM THE INTEREST AND THE EXCHANGE RATE IN THE HANDS OF NATIONAL POLICY MAKERS IT STRAINS CREDIBILITY THAT A PARTICIPANT SHOULD FIND HERSELF UNABLE TO DEVISE A PREFERRED COMBINATION OF FISCAL AND STRUCTURAL INSTRUMENTS WHICH IS FULLY COMPATIBLE WITH A PERMANENTLY FIXED EXCHANGE RATE AND A COMMON MONETARY POLICY



ANYWAY, FOR THE SHORT TERM THIS VIEW HAS NOW BEEN OVERTAKEN BY THE CURRENT DIVERGENCES IN ECONOMIC PERFORMANCE AND OUTLOOK

THE CURRENT CHALLENGE IS NOT TO CONFOUND THE SIGNIFICANT FLEXIBILITY/GENEROSITY/SOLIDARITY REQUIRED TO TAKE ALL EMU PARTICIPANTS BEYOND THE CRISIS WITH THE DESIRABLE LONGER-TERM FRAMEWORK WHICH COULD RETAIN SOME OF THE ORIGINAL FEATURES OF EMU

FROM THAT PERSPECTIVE MANAGING THE FINAL EXIT FROM CRISIS AND CRISIS MANAGEMENT SEEMS MORE URGENT THAN REFORMS OF THE LONG-RUN FRAMEWORK – FOR BOTH ECONOMIC AND POLITICAL REASONS

THAT IS A DIFFERENT SEQUENCE OF PRIORITIES THAN THE REPORT OF THE FIVE PRESIDENTS HAS SET OUT

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