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EMU Forum 2016 – Completing Economic and Monetary Union
Opening remarks, day 2

Ladies and gentlemen,

Let me welcome you again, at this second day of the EMU Forum with the title "Completing Economic and Monetary Union" (EMU), organized by the OeNB together with the *Euro50 Group* and the *Vienna Institute for International Economic Studie*s (wiiw).

We will have four sessions today, each of which reflects one of the main sections of the Five-Presidents' Report. In the first session on **economic union,** we will address the question whether convergence in the euro area is feasible or just a pious wish. The answer to this question depends on what type of **convergence** between Member States we mean: Should the gaps in GDP per capita narrow? Or should just business cycles develop in parallel? Or should the economies develop more structural similarities? As soon as we know where we want to go, the question remains on how we get there. Since the crisis we have already developed some tools: e.g. the *Macroeconomic Imbalance Procedure* and more recently the national *Productivity Councils*. Still, the task of symmetric adjustment of imbalances lies ahead (both, surpluses and deficits in current accounts). Another objective of economic union is simply to enhance **growth**. Current estimates of potential growth are at a mere 1.2% – which is far too low. An important tool for improvement is the *European Fund for Strategic Investment*, the so called "Juncker Plan," which tries to leverage public through private investment. The European Commission wants to extend this plan for another three years. So far, the fund has had some noticeable impact (roughly 4% of total investment, not adjusting for deadweight effects). Whether it will prove to be a game changer remains to be seen.

The next session will aim to shed light on the question whether **financial union** is a tool for risk sharing in EMU through integrated banking and capital markets. So far, the **banking union** mainly comprises uniform supervision and resolution management. The finalization of the banking union by introducing a fiscal backstop of the *Single Resolution Fund* (via an ESM credit line) and a proper *Deposit Insurance Scheme* is still being negotiated. I am convinced that a fair compromise between risk reduction (lowering the *home bias* of banks' exposure to sovereign debt) and risk-sharing is in everyone's interest in terms of financial stability. At the same time, the rationale for **capital markets union** builds on two elements of economic analysis: First, the euro area has become over-reliant on banking with the establishment of EMU, and this bank bias is associated with more systemic risk and lower economic growth than in the U.S.A., where stock and bond markets are much better developed. Second, cross-border risk-sharing mechanisms are significantly less effective in smoothing incomes in the euro area, not least because banks reduce their cross-border exposures exactly in times of crisis, leading to financial fragmentation. Overall, the creation of integrated, diversified European capital markets is a long-term task, and it may well take a few decades to approach the level of integration observed in the United States. The importance of financial market development should, however, not minimize the efforts to regulate capital markets (*fin-techs*, shadow banking), to identify their potential for market failure and address consumer protection interests. Think of the millions of pensioners in the U.S.A. and Europe who saw their savings dwindle during the crisis.

The second afternoon session will look into the prospect of a **fiscal union** with a treasury for the euro area and the chances of achieving public risk-sharing, a reduction of risk and joint debt management. Given the fact that neither market discipline nor slowly developing financial union is enough to ensure fiscal sustainability some **macrofiscal coordination** is needed in order to urge budgetary consolidation but also a growth-friendly fiscal stance of the euro area as a whole. The *Stability and Growth Pact* has been an attempt to realize these aims via rules and peer pressure. However, coordination cannot guarantee successful financial crisis management, which requires swift decisions by a powerful **institution**. Hence the idea of a euro area treasury or finance minister, as sketched by the five Presidents. A euro area treasury could also emit euro bonds, with joint liability as it has enough clout to limit moral hazard. Synthetic euro bonds with several liabilities, such as the *European Safe Bonds* proposed by Princeton economist Brunnermeier, would not even need a further step toward fiscal union, but could still deliver safe assets, which are badly needed for a complete banking union with reduced home bias risks. It is hard to imagine a euro area treasury without its own budget or at least *fiscal capacity* supporting public investment for euro area-wide public goods. But the five Presidents did not prioritize an EMU budget, given its presumably small size compared to national budgets, but instead came up with a proposal on fiscal risk sharing which they call a *common macroeconomic stabilization function*. What they have in mind is a kind of automatic cross-border stabilizer, provided, for instance, by a common unemployment insurance or re-insurance scheme. A creative variation of this idea is the proposal of a *European short-time working allowance* as a first step, which would imply less harmonization pressure since only few countries have such allowance schemes.[1]

In the last policy panel, we will discuss how **political union** could make sure that new institutions, such as a European treasury, are based on the principle of democratic accountability. The general idea is that Member States gain sovereignty by pooling it. At some point, however, this would require a Treaty change in order to make sure that **legitimacy** comes from elected parliaments, either European or national ones, depending on the nature of the institution. However, European democracy does not necessarily mean "more Brussels." According to the **subsidiarity** principle, each level should do what it can do best. But if we decide to share competences in certain areas, the affected citizens must also have an influence on the respective decisions at supranational level. Governance reform that implies a **Treaty change** is difficult to sell in times of general **skepticism** exemplified through the Brexit vote or populist election victories. Distrust may be caused by divergence in prosperity between and within Member States, which could also be the result of globalization, digitalization or faulty economic policies. I think, however, we should never stop explaining that moving forward toward a more stable, prosperous and fair EMU is in the very best interest of all its citizens.

Ladies and Gentlemen,

The first session will be chaired by Kurt Pribil, Executive Director and Member of the Governing Board of the OeNB. Previously, he was Executive Board Member of the Austrian Financial Market Authority, Head of the OeNB's Foreign Research Division, Economic Advisor to the Minister of Economic Affairs and OeNB representative in Brussels.

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[1] Becker, P. 2016. Ein europäisches Kurzarbeitergeld als Schritt zur Sozialunion. http://www.swp-berlin.org/publikationen/kurz-gesagt/ein-europaeisches-kurzarbeitergeld-als-schritt-zu-einer-europaeischen-sozialunion.html

Dear Kurt,

The floor is yours.