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Economic and financial priorities for relaunching the Eurozone and the EU

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A window of opportunity

Half a year ago, newspapers across the continent and beyond were brimming with stories about Euroscepticism. By now, and contrary to these stories, we have seen that pro-European policies can garner political support. The latest Eurobarometer survey shows that Euroscepticism is receding and that trust in the EU and the euro continue to increase.

At the same time, the economic and financial situation in the euro area has improved considerably in the last years: since early 2015, euro area GDP growth has been solid in every quarter with an average of 1.9 % in annualised terms; more than six million jobs have been created since the recovery began in the last quarter of 2013; employment has surpassed its pre-crisis peak of early 2008. Nevertheless, there is still considerable slack in a number of euro area countries which are burdened with high unemployment. Stock imbalances also remain in other areas, such as the level of NPLs in the euro area banking sector, or the large negative net international investment positions in countries that in the years prior to the crisis were running high current account deficits. Thus, there is a clear need for further action.

The favourable economic as well as political environment present a unique window of opportunity to fix the shortcomings of our economic and monetary union and relaunch the Eurozone – as the title of this session suggests. The June 2015 Five Presidents' report presented the outline of a roadmap to that effect; the European Commission's reflection paper on the deepening of EMU further developed the contours of a roadmap. Before going into the specifics, let me make a few more general remarks.

Learning from history - strengthening the Union

Let us not forget that the EU is a union of Member States but it also has to be a union of European citizens. Their elected representatives at the European level and the Union institutions should drive the agenda on the future of the EU, not a few Member States. As much as I welcome a Franco-German initiative to revive the debate on EMU deepening, this should not become an alternative or parallel process that might come at the expense of other, in particular smaller Member States. History teaches us that European integration has been most successful when it was based on the community method, not intergovernmentalism. This is because it allows all Member States to commonly share sovereignty in a democratic, transparent and inclusive manner.

Speaking as a central banker of a genuinely European, you might even say federal institution, let me elaborate further on this institutional point. We should avoid entertaining the illusion that competences have been effectively transferred to the European level, even if this may be *de jure* the case, when they are still largely *de facto* controlled at the national level. This risks creating confusion among citizens who are legitimately asking for effective policies that address their needs.

On the contrary, if we want to progress along the path of further European integration, there needs to be alignment of sovereignty and responsibility on the one hand and legitimacy and accountability on the other hand. In other words, where competences are given to the European level, they should be part of the Union framework, with clear institutional independence, instruments to accomplish the responsibilities transferred, full democratic accountability and judicial control. For me, the single monetary policy framework put in place and enacted in the EU Treaties provides a fine example to that effect. Europe seems less effective in areas were competencies are shared between the Union and the national level, even in cases where the Union is imposing a rule-based framework. Europe is even less effective in areas where the intergovernmental approach is indefinitely preferred over the Union method.

Financial and economic priorities

Let me be more concrete now on what I consider to be the EMU deepening priorities:

- **Financial Union**: Completing the Capital Markets Union (CMU) and Banking Union should be among our top priorities. They are each other's natural complements. Both a genuine CMU and a true Banking Union not just support a homogenous and smooth transmission of the ECB's monetary policy measures, but they ensure that savings are allocated in the most efficient way to productive use in the form of investment across the area, regardless of their national location. In creating an ever more robust financial integration, we will facilitate private risk-sharing which will help to make our economy more resilient to shocks and we will become less reliant on public risk sharing to do this job. In particular Banking Union must not be left unfinished, given the importance of the banking sector in the financing of the euro area economy. A single currency for all euro area citizens needs to be complemented by a single banking system so that 'a euro is a euro' is the shared conviction of everyone holding it in his pocket or in a bank deposit.
- **Fiscal and economic governance**: While the economic governance framework has been strengthened in response to the crisis, we see that the Stability and Growth Pact (SGP) and the Macroeconomic Imbalances Procedure (MIP) are insufficiently delivering on guiding countries to implement comprehensive structural reforms and to live up to fiscal policy recommendations. The implementation of the country-specific recommendations is poor, to say the least. A full, transparent and consistent implementation of the rules is thus essential, also to build confidence and trust for further steps in terms of sovereignty sharing.

At the same time, other European instruments can also be of help in providing carrots, not just sticks. For example, the instruments of the Single Market are not yet used to their full potential in the field of economic policies also to induce further reform momentum. Technical support from the European level, for example through the Commission's Structural Reforms Support Program, can also support reform efforts. And the EU budget can play a role – albeit in a limited way - in providing public goods to EU citizens.

A euro area fiscal capacity with own resources managed at the central level could undoubtedly do much more, in particular to pursue union-wide macroeconomic stabilisation goals, by offering funding to member countries hit by external shocks for purposes that would otherwise remain unfunded. Public investment funding offers a good example, when looking at what crisis-hit euro area countries did in the earlier years of this decade.

There can be no question that such a pooling of resources requires sufficient economic convergence among participating countries and effective borrowing constraints at the Member State level. This begs the question of how to design this convergence process. The key challenge will be how to create a conditionality architecture that supports reforms while setting the right incentives in order to avoid the creation of a transfer union. But it would be a fallacy to believe that an intergovernmental approach could do a better job at this than the Community method. Building coalitions of the 'willing' to make progress in this direction would in my view also be the wrong approach.

Of course, a euro area fiscal instrument will require adequate institutional backing which in turn might necessitate a change to the Treaties. The appetite for such an endeavour has been notoriously low for many years. However, the fear of Treaty change should not deter us from discussing what is necessary to put our Economic and Monetary Union on a more solid footing. I remain convinced that European nations and citizens are willing to share more sovereignty in policy areas where national member states are increasingly less able to tackle the challenges on their own. But citizens rightly ask for a concrete roadmap in which policy fields sovereignty need to be shared and how such powers at the central level are controlled and legitimised. Once we have convincing answers to these questions, Treaty change will lose its trepidation.

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