Exploring a new Economic and Monetary Union

Assessing the European Council of 18-19 October 2012

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What has been at stake?

The political tide has been changing, but not clearly enough. The June European Council had recognized the need of re-balancing fiscal consolidation with growth and investment as well as the need to disconnect bank crisis from sovereign debt crisis in order to overcome the euro-zone stalemate. With this purpose, bolder measures had been agreed, notably: (1) the possibility of direct re-capitalization of banks by the European Stability Mechanism in order to avoid further burden on public deficits and (2) the possibility for the European Central Bank to buy national bonds in the secondary markets in order to bring down too high level spreads in some countries, notably Spain and Italy. The main purpose was to build firewall to avert new cases in the domino effect of the previous years.

Nevertheless, over summer time, progress on these commitments has proved to be hesitating and patchy because the underlying divergences are always there:

- The operationalization of the new European instruments to support investment has been particularly slow: strengthening the capital base of the European Investment Bank in order to increase its lending capacity; stepping up the implementation of the structural funds; launching the project bonds in their pilot phase. In the meantime, economic recession has been spreading in more countries, including the Netherlands, and has been particularly deep in Greece, Portugal, Ireland and Spain. Strangely enough, the Troyka programmes have not been re-aligned with this more balanced approach between fiscal consolidation and growth, sticking to ambitious targets to reduce the nominal deficits and weakening these economies with a lethal mix of spending and wage cuts and increasing taxes.

- The possibility to recapitalize banks directly with ESM had been made dependent on submitting these banks to a new single European bank supervision structure led by the ECB, and building such a structure is a complex process confronted with many obstacles: some Member States (notably Germany) wanted to confine the supervision coverage only to the major and not to all banks; other Member States (notably Poland) wanted to ensure that non-euro-zone countries would have a say; other Member States (notably UK) were keen to protect the integrity of the single market and of the competences of the previously created EBA, European Banking Authority, located in London. Furthermore, the burden of bank resolution should move from tax payers to banks themselves and should involve more European coordination, two moves confronted with deep resistances.

- The only spectacular development took place when Mario Draghi managed to approve in ECB board a new set of instruments called OMT to intervene in the secondary markets in order reduce the pressure of financial markets when they lead to unsustainable spreads. The final vote was not easy, as the German representative has voted against, in spite of the compromise solution crafted by Draghi with the acquiescence of Merkel: these new instruments can only support a country if it previously makes a formal request to the European Stability Mechanism and accepts a specific conditionality for this support. The conditionality issue has open a bitter discussion in Spain, because the previous examples of this kind of conditionality, mainly focused on fiscal consolidation was leading to deep recession in other countries. Hence the calendar for a Spanish rescue was gradually postponed, something which was also in line with preferences of the German government, who wanted to secure, first of all, the ratification of the New Fiscal Treaty by France and the final approval of the European Stability Mechanism by Kalrshure Constitutional Court in Germany- both of them to take place in September. These were indeed two crucial pieces of the new architecture of the Economic and Monetary Union which has been designed over the last two years, under German government inspiration: some inter-governmental solidarity against sovereign debt crisis in exchange of tough conditionality and of a definitive commitment with balanced budgets.

In parallel, a more fundamental work on the architecture of the Economic and Monetary has been developed over summertime, by a quadriga composed by Barroso, Draghi and Juncker and led by the President of the European Council Van Rompuy, who has launched a consultation process by visiting the PMs in their capitals, by involving their sherpas and also by the normal process of COREPER.

A draft document under the label “Towards a genuine Economic and Monetary Union” was proposing some building blocks and some bolder instruments:

- A banking union, comprising a single supervisory body, a single rule book, but also the harmonization of the national deposit guarantees and of the national resolution schemes, in view of a later common scheme.

- A economic union equipped with macro-management tools and possible contractual arrangements with Member States for coordination, convergence and enforcement in view of growth, employment and social cohesion

- A budgetary union based on common rules of fiscal discipline, to be coupled with a special fiscal capacity for the euro-zone as well as some possible instruments for joint issuance or management of the public debt such as euro-bills, Eurobonds and a redemption fund to reduce the service of previous public debt

- A political framework to provide the democratic legitimacy and accountability which should underpin the above mentioned developments, notably by strengthening the role of the European and the national parliaments.

Hence a more systemic and comprehensive discussion was also entering in the central political stage, raising another central malaise of the European integration: who could take such a boat to complete the Economic and Monetary Union? Was this leading to a “several speeds Europe”?

The political game

The political game became more diversified over this period. Prime Ministers visiting Brussels and Van Rompuy visiting capitals. PMs visiting Berlin, but also Merkel visiting capitals of the most hit countries: Italy, Spain and even Greece. But beyond this, Monti also meeting with these countries' Prime Ministers to test possible common positioning. Finally Hollande, who has received all of them, one by one, and finally came out with a comprehensive position, alternative to Merkel's one, and setting the terms of the debate which should take place inside the European Council meeting of 18-19 October.

In the meantime, the two major European political families were also re-organizing themselves by defining their political agendas and electing their leading bodies. Sergei Stanishev became President of the PES in a Congress held in Brussels on 28-29 September, while Wilfried Martens would be confirmed as in a EPP Congress held in Bucharest on 17-18 October. Furthermore, a third grouping of forces was suggested by a joint publication authored by two leading MEPs Guy Verhofstadt and Daniel Cohn-Bendit , under the label "For Europe".

The preparatory meetings before the European Council have also become more instrumental, with Hollande coming for the first time to the PES PMs meeting, where he set the tone, building on a comprehensive public position he had exposed on the eve to seven European newspapers. This public position was exposing his alternative vision in contrast with the German Government's one; presented one day before by the Finance Minister Schauble and re-stated by Merkel in the Bundestag in the very day of the European Council.

Behind this discussion,   there are more fundamental issues at stake which will re-shape the process of European integration for the next years.

See below a brief comparison of the recent positions taken by both, German Government and French Government(GG/FG) regarding this list of fundamental issues.

1. What should be the balance between growth and fiscal consolidation?

GG: keep the focus on austerity in programme countries. Lagarde and IMF are wrong when saying that too much austerity is counterproductive. Spain application should be delayed as much as possible;
FG: The moment has come to give more time and means for these countries to recover and see their reform effort compensated. In these new conditions, Spain can also apply.

2. What should be the balance between national responsibility and European solidarity?

GG: the main responsibility is with these Member States. Solidarity, only with tough conditions and it has reached its limits;
FG: to make national efforts effective, solidarity needs also to be more effective: banking union, Eurobonds.

3. What should be the building blocks of the new Economic and Monetary Union ?

GG: social union is ignored; economic union is focused on structural reforms and macro-economic surveillance; banking union limited to systemic banks;
FG: social union referred explicitly; economic union also comprising European investments and macro-economic coordination between surplus and deficit countries.

4. What kind of new instruments should be developed: intergovernmental or Community approach?

FG: intergovernmental approach in designing the ESM, the European banks resolution scheme, the macro-economic surveillance. Nevertheless, the Eurozone Minister of Finance should also be Vice- President of the European Commission
F: explicit reference to partial joint-issuance of bonds, the rest not clear yet. When national citizens perceive their lives as depending not on European solidarity to complement their efforts, but on the decisions of another MS parliament, the very idea of democracy and of Europe is undermined.

5. What should be the national scope of these developments?

FG: Hollande refers explicitly to the need of different speeds to move quicker, with a core group open to all Member States who want to join
GG: not clear, but probably with similar approach

6. How to manage this political process to deepen European integration?

GG: to put the focus on creating a Eurozone Finance Minister, to better enforce fiscal discipline, structural reforms and austerity conditionality of any kind of solidarity.
FG: Beginning of 2013, Eurozone summits should meet monthly to develop the sequence banking union, economic union, social union, budgetary union. Deeper political union (which will certainly require Treaty changes), should only be discussed after European elections; Banking Union should cover all banks.

Key issues for an assessment of the European Council of 1-2 March

General approach
The European Council recognizes the need of stronger priority for growth and of completing the EMU to overcome the crisis, but the concrete measures are always lagging behind what is needed, so the crisis will go on and might even worsen

Compact for Growth and Jobs
There is pressure for quicker implementation of June measures to support investment (EIB, structural funds, project bonds), but this is being hindered by the pressure for quick public deficit reduction, even when there is economic recession. The downward spiral might go on, with extreme cases in programme countries

Financial Transaction Tax
The financial transaction tax moves finally forward due to enhanced cooperation involving 11 countries, but there are still some final obstacles to be removed

Jobs

An employment package is being prepared including youth guarantees and traineeships, but many details are still to be clarified and financing still missing

Industrial Policy

It is recognized that industrial policy should be developed as a tool for growth and jobs, but this is almost ignored in the assessment of the national reform programmes

Banking Union

It was decided to harmonize national resolution mechanisms and deposit guarantees and that all banks should be covered by the supervision, even if the local ones only indirectly, of the ECB. There was an agreement to achieve a single supervision mechanism and a single rule book with a deadline, but the deadline was delayed for the end of 2013 (meaning waiting for German elections). There is no reference to common resolution mechanism and deposit guarantee and the European Council remains ambiguous on the recommendation to separate investment from retailing banks

Disconnecting sovereign debt crisis from bank crisis

Setback in June compromise on the direct re-capitalization of banks by the ESM. This one was delayed for the end of 2013, meaning more problems particularly for Spain and Ireland and pushing Spain for a full rescue.

Budgetary Union

The European Council recommends to organize the European Semester with stronger involvement of the European and national parliaments.

The European Council recognizes need of countercyclical instrument, but with several ambiguities. The so-called “un-relation” with the Multiannual Financial Framework requires new resources and should respect the European Parliament role

Economic Union

The European Council underlines the need of a stronger coordination, convergence and enforcement for growth, employment and social cohesion. The so-called contractual arrangements with individual Member States remain risky in their intentions: do they intend to replicate the troika self-defeating recipes or rather improving the coordination of national policies?

General architecture of the Economic and Monetary Union

The reference of social elements is starting to be introduced (social cohesion and social welfare are used words), but their elaboration is still very poor.

Remarks for the Future

We are leaving an historical period. Deepening European integration has become a matter of European vital interest. But what is fundamentally at stake is to choose the method to deepen this European integration: inter-governmental or community method?

In this context the current discussion about a euro-zone budget is also particularly meaningful. Provided it fully respects the size, scope and purpose of the Community budget, and provided it is properly designed, this new instrument can become a pass way for:

- Equipping the EMU with a crucial counter cyclical tool for Member States which have lost all them by definition
- Leveraging the European resources
- Providing a basis to issue Eurobonds and loans
- Creating a embryo of a European Treasury
- Paving the way for European specific taxes
- And for a stronger role of the European Parliament, because there is no taxation without representation…

Another central issue should be about what is being called Social Union. If there is not a clear frame for social coordination and convergence when the Member States accept sharing higher levels of their financial, budgetary and economic sovereignty, the normal consequence will be intensification of competition between them, notably by downgrading their social conditions. This is something economic theory can predict with a high level of certainty. This trend will first affect the euro-area members with lower competitiveness and will spread gradually to all the others, creating a downward spiral based on a institutionalized social dumping, which will downgrade, wages, social contributions, social standards and ultimately the basic ingredients of quality of life and of forward looking competitiveness in Europe. Later on, this trend will also undermine the economic, financial and fiscal stability of the EMU, due notably to uncontrolled movements of people and capitals.

Therefore, which are the minima conditions to consider this indispensable social dimension when reshaping the EMU towards the new envisaged one?

- A clear definition of basic social standards to be respected in the euro-zone, and to be promoted in the relationship between the EU and its external partners
- A definition of targets for social progress in the frame of the European growth strategy
- A stronger monitoring and coordination of social reforms and jobs plans in the frame of the national reform programmes
- Stronger means for social investment to be considered in the Community Budget and in the European surveillance of the national budgets. These means for social investment should be used as conditional incentives for the progress in these social targets and reforms
- A surveillance of the macroeconomic imbalances and a better macroeconomic coordination, which should also consider their social indicators and not only the economic and financial ones
- The development of a European Fund to cushion major social macroeconomic shocks, if there is higher coordination of euro-zone Member States regarding tax and social contribution policies
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Finally, these developments also require an adaptation of the current institutional setting:

- Meetings to improve the coordination of Social ministers regarding the specific issues of the eurozone, which should also involve the European Commissioner for Social Affairs
- A more active role of the European Parliament in the different stages of the European semester and its internal organization to deal with the specific issues of the eurozone
- The development of procedures of social dialogue able to cope with the specific issues of the euro-zone

All these issues should be carefully examined in the near future.