Monetary union and the single market: what governance challenges?

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How governance “geometry” became more variable and complex
What further steps are needed to stabilize the euro area?
Two parallel and potentially contradictory logics: monetary union and single market
Policy implications
Timeline of events

10-year government bond yields (%)

Lehman collapse
Debt crisis
ESM signed
European Council announcement on BU
Speech by Mario Draghi
QE

Source: Bruegel based on Datastream
Key governance decisions already taken

- European Stability Mechanism (ESM)
- Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG)
- Sixpack (fiscal law package of 5 regulations and 1 directive)
- Banking Union (BU)
- OMT programme
Variable geometry pre-crisis
Variable geometry now

**BU:** Banking Union, BU is in principle open to all EU countries, see Darvas and Wolff (2012), “Should non-euro area countries join the banking union?”

**TSCG:** Treaty on Stability, Coordination and Governance (Fiscal Compact)
### Legal framework

<table>
<thead>
<tr>
<th><strong>Outside the Treaty</strong></th>
<th><strong>Inside the Treaty</strong></th>
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<tbody>
<tr>
<td>European Stability Mechanism (followed an amendment of Article 136 of the Treaty)</td>
<td>Single Supervisory Mechanism (SSM) (Article 127.6 of the Treaty)</td>
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<tr>
<td>Fiscal Compact (intergovernmental treaty ratified by 25 member states, except for Czech Republic, UK, Croatia)</td>
<td>Single Resolution Mechanism (SRM) (Article 114 of the Treaty)</td>
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**Single Resolution Fund**

Transfer of contributions raised nationally towards the Single Fund and the mutualisation of the national compartments is set out in an Intergovernmental Agreement (IGA) between 26 participating Member States.

The Fund and the decision-making on its use is regulated by the SRM Regulation. National contributions will be merged to the Single Fund after 8 years of transitional period.
The euro area: an unfinished construction

- Banking union
- Adjustment in EMU
- Low inflation
- Risk sharing: which channels?
- Debt overhang
% of shock smoothed by the different channels:

On a number of dimensions, EU requires different forms of integration than EA.

Deeper EA integration with more political integration: what consequences for political and governance relations with the non-EA countries and in particular the opt-outs?

What is the issue at conceptual level?

Where are we in practical terms?

What governance/reform issues are currently discussed (at least in Brussels)?
Two fundamental logics - Concepts and theory

<table>
<thead>
<tr>
<th></th>
<th>Economic and Monetary Union</th>
<th>Single Market</th>
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<tbody>
<tr>
<td><strong>Labor</strong></td>
<td>Labor mobility as adjustment mechanism in OCA (Mundell, 1961)</td>
<td>Free movement of people for better allocation of labor (Zimmerman, 2013)</td>
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<td></td>
<td>- More integrated labor market legislation</td>
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<tr>
<td><strong>Capital and Financial</strong></td>
<td>Important risk-sharing mechanism for asymmetric shocks (Asdrubali, Sorensen and Yosha, 1996)</td>
<td>Better allocation of capital (more a question of convergence) (Abiad, Leigh and Mody, 2007)</td>
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<td></td>
<td>- More integrated capital markets</td>
<td></td>
</tr>
<tr>
<td><strong>Banking</strong></td>
<td>Shock absorption through credit, maintain access to credit</td>
<td>Allocation of capital (Allen, Bartiloro and Kowalewski, 2005)</td>
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<td></td>
<td>- More integrated banking</td>
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</tr>
<tr>
<td><strong>Budget</strong></td>
<td>Shock absorption through fiscal transfer to region hit by shock (Kenen, 1969)</td>
<td>Common budget acts as an allocation mechanism and compensation of losers (i.e. agriculture) (see Mariniello, Sapir and Terzi, 2015 on distributional considerations)</td>
</tr>
<tr>
<td><strong>Fiscal</strong></td>
<td>Fiscal coordination for proper fiscal stance</td>
<td>Weaker contagion (see Hallerberg, Strauch and von Hagen, 2007 on different forms of fiscal governance in the EU)</td>
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<td></td>
<td>Fiscal sustainability in the monetary union, preventing monetary financing and contagion</td>
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<td><strong>Structural and Other Economic Policies</strong></td>
<td>Policy shifts have a much bigger implication on the EMU than the SM (i.e. tax, social security, energy)</td>
<td>(Single Market initiatives- Digital Single Market, Energy Union)</td>
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## Two fundamental logics - Institutional assessment

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<tr>
<td><strong>Labor</strong></td>
<td>Free labor mobility</td>
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<td>No common Euro area labor market policy, but loose coordination</td>
<td></td>
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<tr>
<td><strong>Capital and Financial</strong></td>
<td>CMU (?)</td>
</tr>
<tr>
<td>Banking Union (SSM, SRM, missing European deposit insurance)</td>
<td>Single Rulebook, EBA</td>
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<tr>
<td><strong>Banking</strong></td>
<td>EU budget</td>
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<td><strong>Budget</strong></td>
<td>Convergence criteria for joining; UK (subject to the corrective arm of the SGP, the Council opened the Excessive Deficit Procedure for the UK on 2 December 2009)</td>
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<tr>
<td>No common budget, but ESM acts as a backstop</td>
<td></td>
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<tr>
<td><strong>Fiscal</strong></td>
<td></td>
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<tr>
<td>Two-pack, Sixpack, SGP, Fiscal Compact (TSCG)</td>
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<tr>
<td><strong>Structural and Other Economic Policies</strong></td>
<td>(Single Market initiatives- DSM, Energy Union)</td>
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<td>Country-specific recommendations given through the Macroeconomic Imbalance Procedure (MIP)</td>
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<td>Policy shifts have a much bigger implication on the EMU than the SM (i.e. tax, social security, energy)</td>
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<tr>
<td><strong>People</strong></td>
<td>Excluding UK (Romania, Bulgaria, Croatia, Cyprus obliged to join)</td>
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<tr>
<td>Excluding Ireland</td>
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5 Presidents’ report on the completion of EMU

The positive elements:
- Monetary union is not sustainable in its current set-up, improvements needed
- Emphasis on structural divergence, again link to **European competitiveness councils**
- **Finalise banking union**: backstop to the single resolution fund & deposit insurance
- **Fiscal union** remains on table

The missing and negative elements:
- Missed the **opportunity to question current system of fiscal rules**
- **Democratic legitimacy** should be emphasized
- Fails to reflect on the **role of non-euro area countries** (opt-out clauses)
- Too little emphasis on **crisis resolution**:
  - Public debt: how to reduce exposure of banks to sovereign debt
  - Private debt: better principles for insolvency legislation

→ A lot of this needs a treaty change!
What is next?

- **Single market initiatives**
  - Capital Markets Union - ?
  - Digital Single Market - ?
  - Energy Union - ?

  **Significant enforcement challenges**
  “While the “old” single market in goods and unregulated services was satisfactorily addressed through standards harmonization, the new single market challenge is all about regulatory enforcement institutions” Nicolas Véron, Bruegel blog “Europe’s Capital Markets Union and the new single market challenge”
David Cameron‘s letter

▪ **Economic governance**
  • legally binding principles that safeguard the operations of the Union for all 28
▪ **Competitiveness**
  • single digital market and capital markets union
  • cutting excessive regulation
  • trade
▪ **Sovereignty**
  • ever closer union?
  • role of national parliaments?
  • subsidiarity fully implemented
  • JHA
▪ **Immigration**
  • limit EU labour mobility, in-work benefits
Two diverging views on governance

▪ Green paper (Commissioner Hill):

‘A capital market union should be built on firm foundations of financial stability, with a single rulebook for financial services which is effectively and consistently enforced.’

*(Building a capital markets union, February 2015)*

▪ 5 Presidents’ report:

‘[…] closer integration of capital markets could lead to risks of financial stability. There will be a need to expand and strengthen the available tools to manage financial player’s systemic risks prudently (macro-prudential toolkit) and the supervisory framework. This should ultimately lead to a single European capital markets supervisor.’

*(Completing Europe’s EMU, June 2015)*
Policy questions

- To prosper, monetary union will need greater integration measures and institution building. This poses governance and political challenges for EU28, safeguards may be limited.
- Deepening single market may require institutions but probably less forceful ones than currency union.
- Frictions are likely to arise and need to be managed proactively.
- Some of David Cameron‘s demand will require treaty change.

→ This is ongoing research, I look forward to discussion!
Thank you for your attention
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References:


Darvas Zsolt and Guntram Wolff (2013). "Should non-euro area countries join the single supervisory mechanism?" *Bruegel Policy Contribution*, Issue 2013/06


Véron Nicolas (2015). 'Europe's capital markets union and the new single market challenge', *Bruegel blog*

TARGET2 balances

TARGET2 balances (€ bn)

Source: Bruegel based on Euro Crisis Monitor
Unit labor cost divergence

Unit labour costs
(2000 = 100)

Source: Bruegel based on European Commission data
Inflation developments

Source: Bruegel based on Datastream
Current account

Current account balance (in % of GDP)

Current account balance (in bn EUR)

Source: Bruegel based on AMECO, Eurostat