

Comments on the Five Presidents' Report

Guntram Wolff

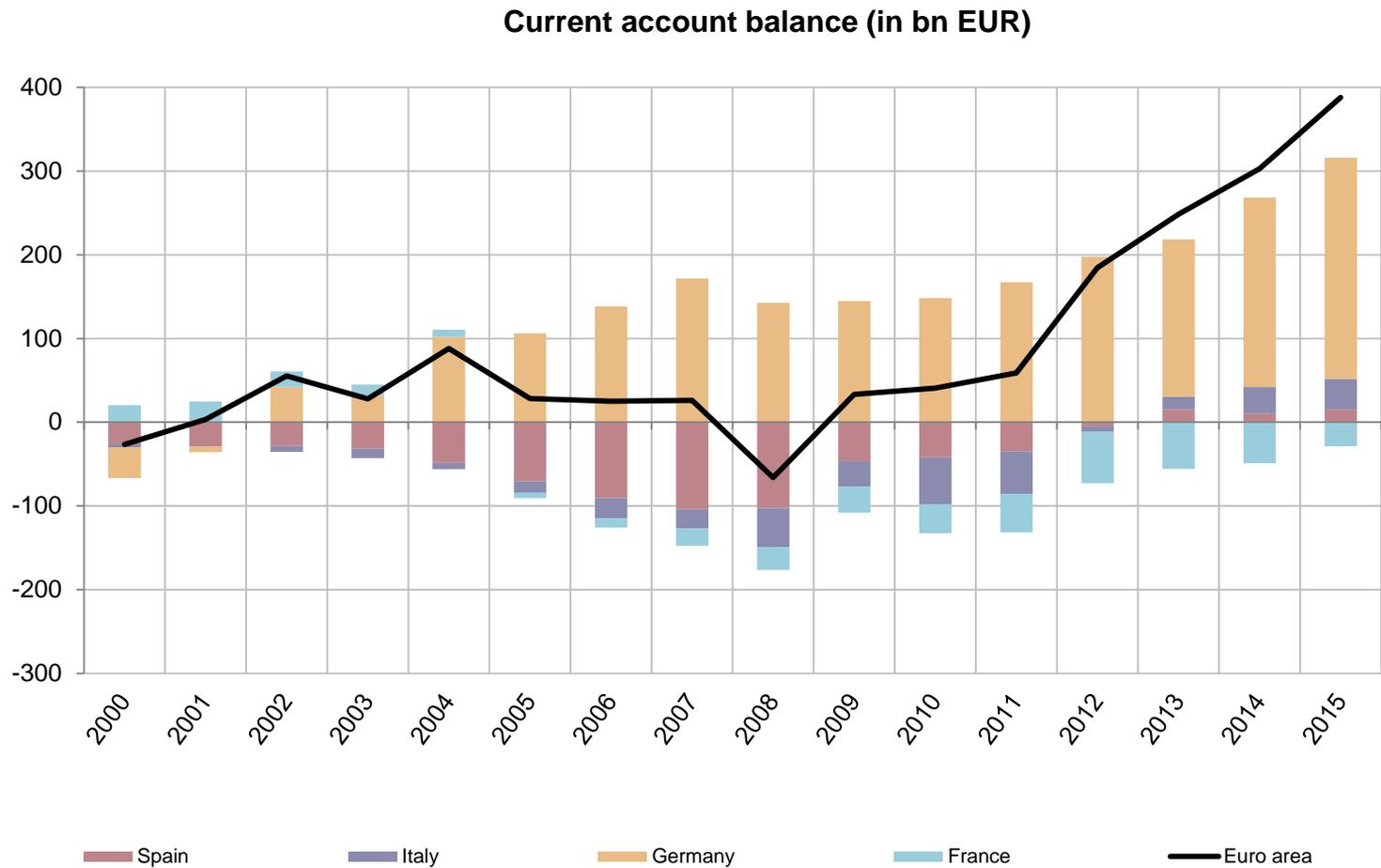
The Hague

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Content of Five Presidents' Report

- **Economic Union**
 - Convergence & Competitiveness
- **Financial Union**
 - Banking Union & Capital Markets Union
- **Fiscal Union**
 - Coordination & Stabilization
- **Accountability, Legitimacy, Institutions**

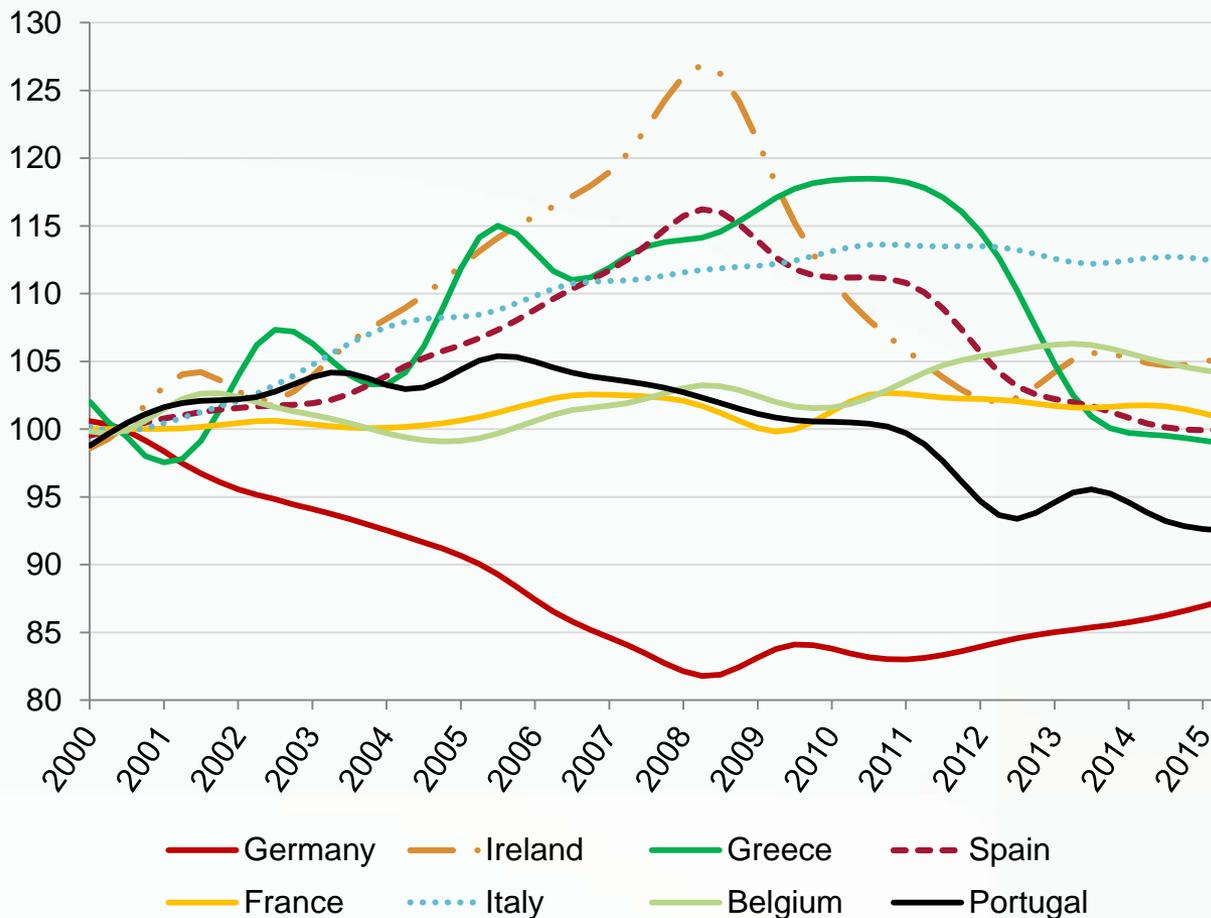
Economic Union: Convergence & Competitiveness



Source: Bruegel based on AMECO, Eurostat

Economic Union: Convergence & Competitiveness

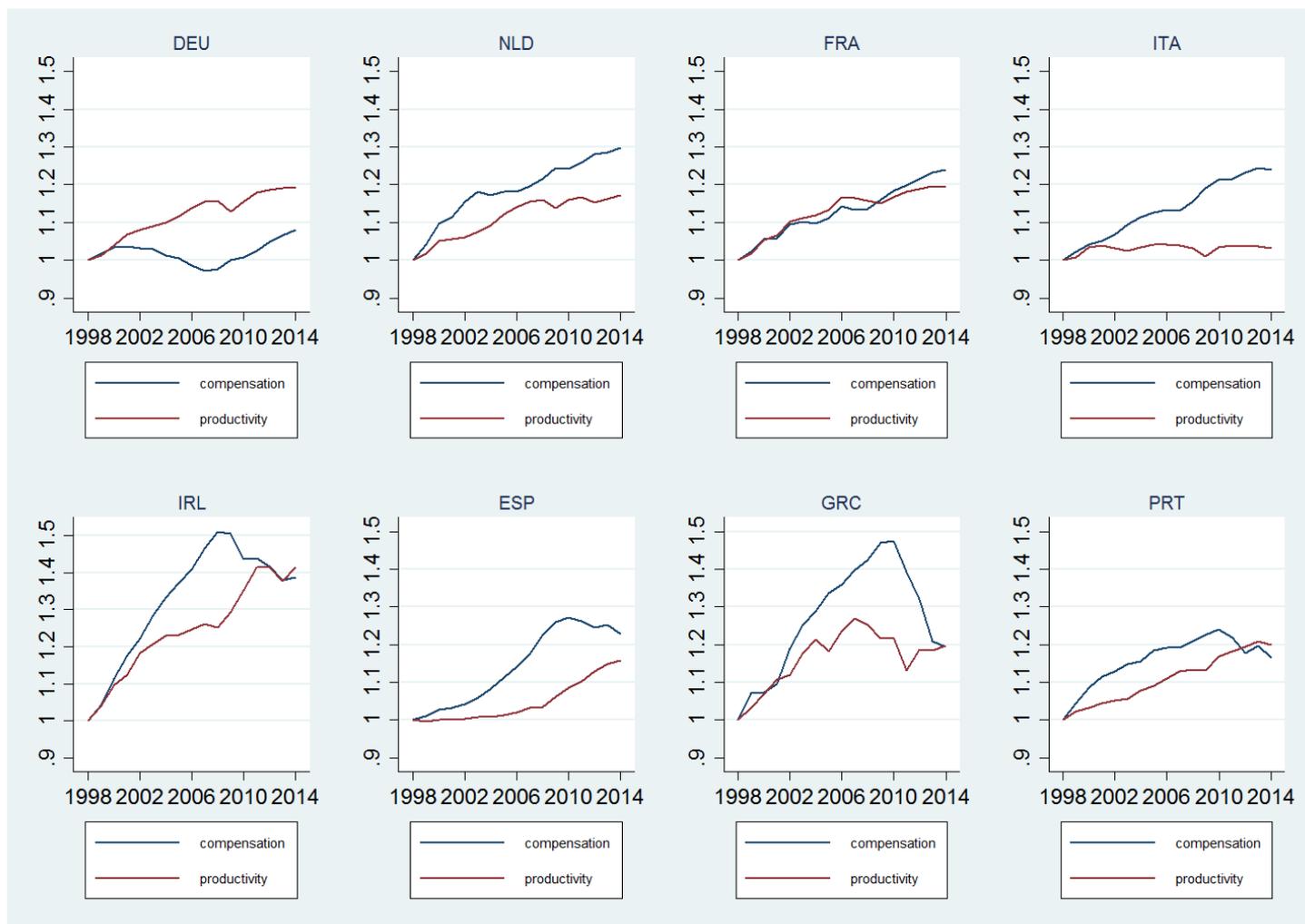
ULC-based real effective exchange rates (vs. EA19)



Source: ECFIN

Economic Union: Convergence & Competitiveness

Compensation and productivity developments



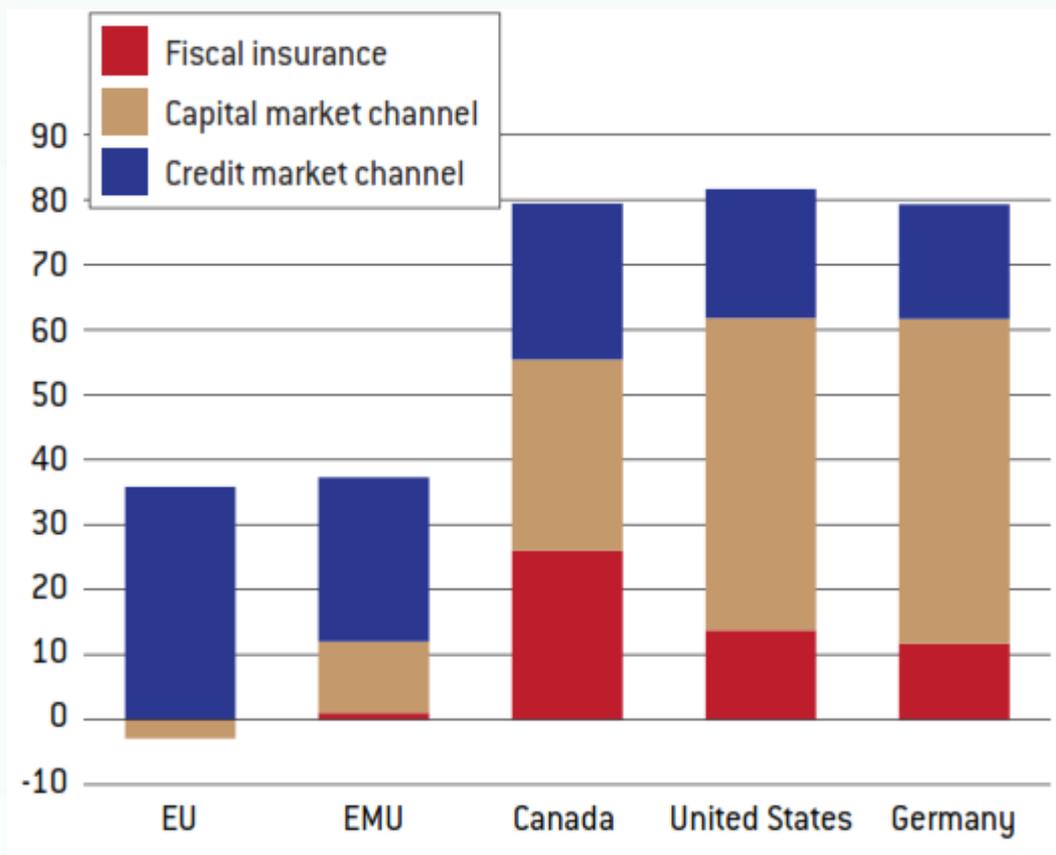
Source: Bruegel based on AMECO; Notes: Compensation is deflated using the EA19 GDP deflator, productivity is GDP per hour worked and is deflated using the national GDP deflators.

Economic Union: Convergence & Competitiveness

- **National wage formation and bargaining systems vary widely → divergences in competitiveness may result**
- **Two solutions (in the absence of exchange rate mechanism, see *Sapir and Wolff, February 2015*):**
 - 1) Creation of single EA labour market, with large migration flows → not desired in foreseeable future
 - 2) MIP?
 - 3) National competitiveness-monitoring frameworks → Creation of **Eurosystem of national Competitiveness Councils**: (focus on wages and on productivity)

Financial Union: Banking Union and CMU

% of shock smoothed by the different channels:



Source: IMF, 'Towards A Fiscal Union for the Euro Area: Technical Background Notes', 2013

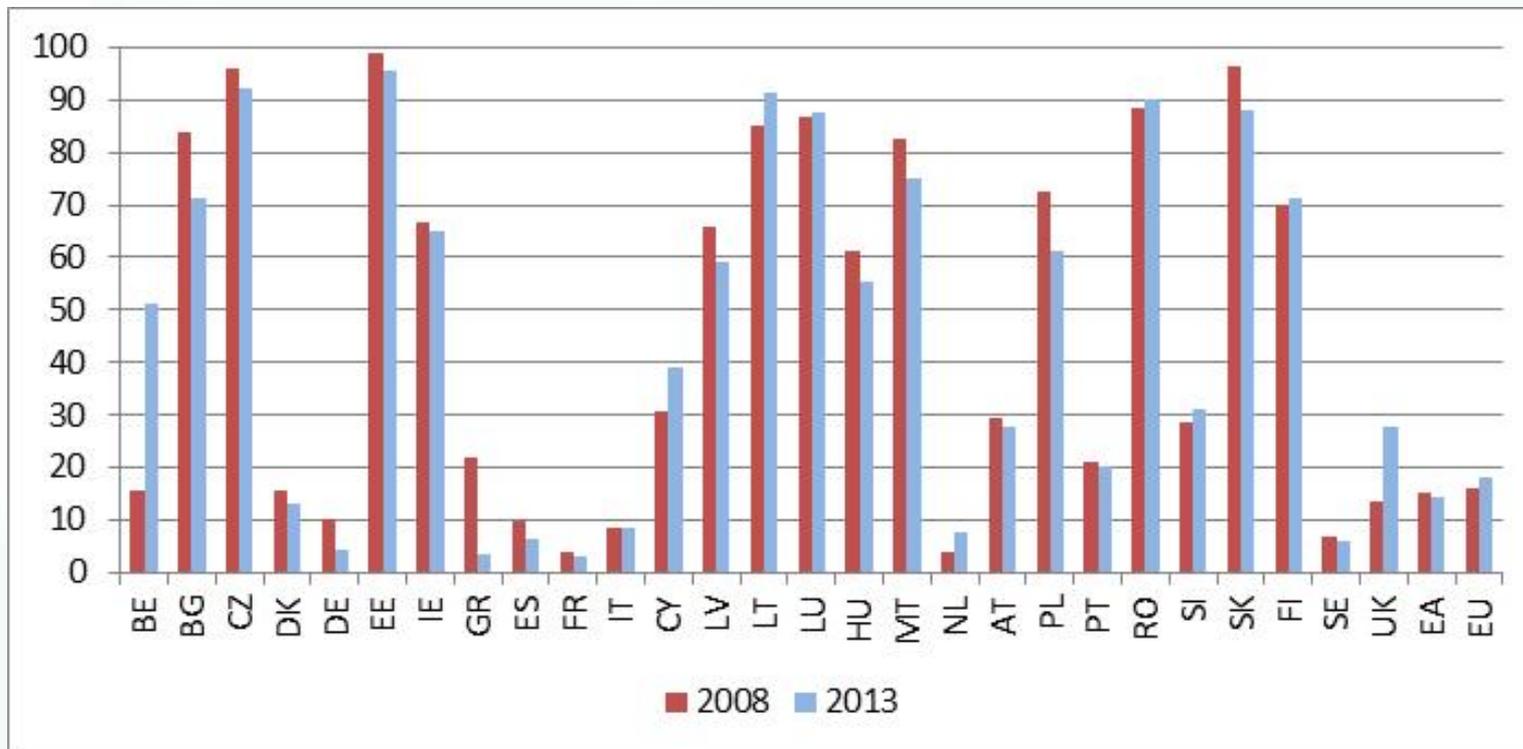
Financial Union: Banking Union and CMU

- **Completing Banking Union**
 - Deposit insurance necessary to complete BU, inconsistency between European supervision and national responsibility
 - EC proposal: EDIS as re-insurance system
 - Risk sharing and risk reduction: Single exposure rules to deal with public debt
 - Better principles for insolvency legislation to address private debt overhang
- **Launching CMU, but progress slow**

Financial Union: Banking Union and CMU

1) Retail banking: constrained by national borders (with small EA and CEE countries as exception, Sapir and Wolff 2014)

Percentage of the banking system that is foreign owned:

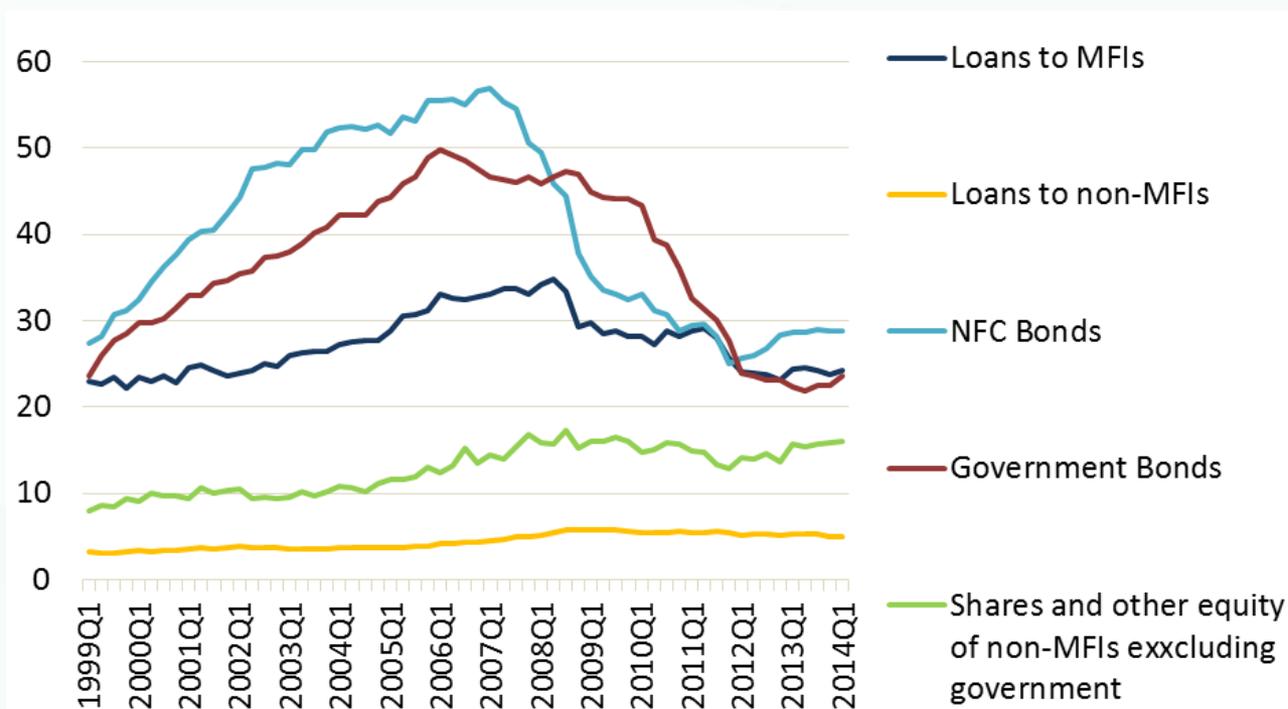


Source:
Bruegel based
on ECB data

Financial Union: Banking Union and CMU

2) Wholesale banking: highly integrated in the run-up to the crisis. Since then, euro area experienced decreasing cross-border interbank financing

Share of cross-border holdings of assets of euro-area MFIs in total assets

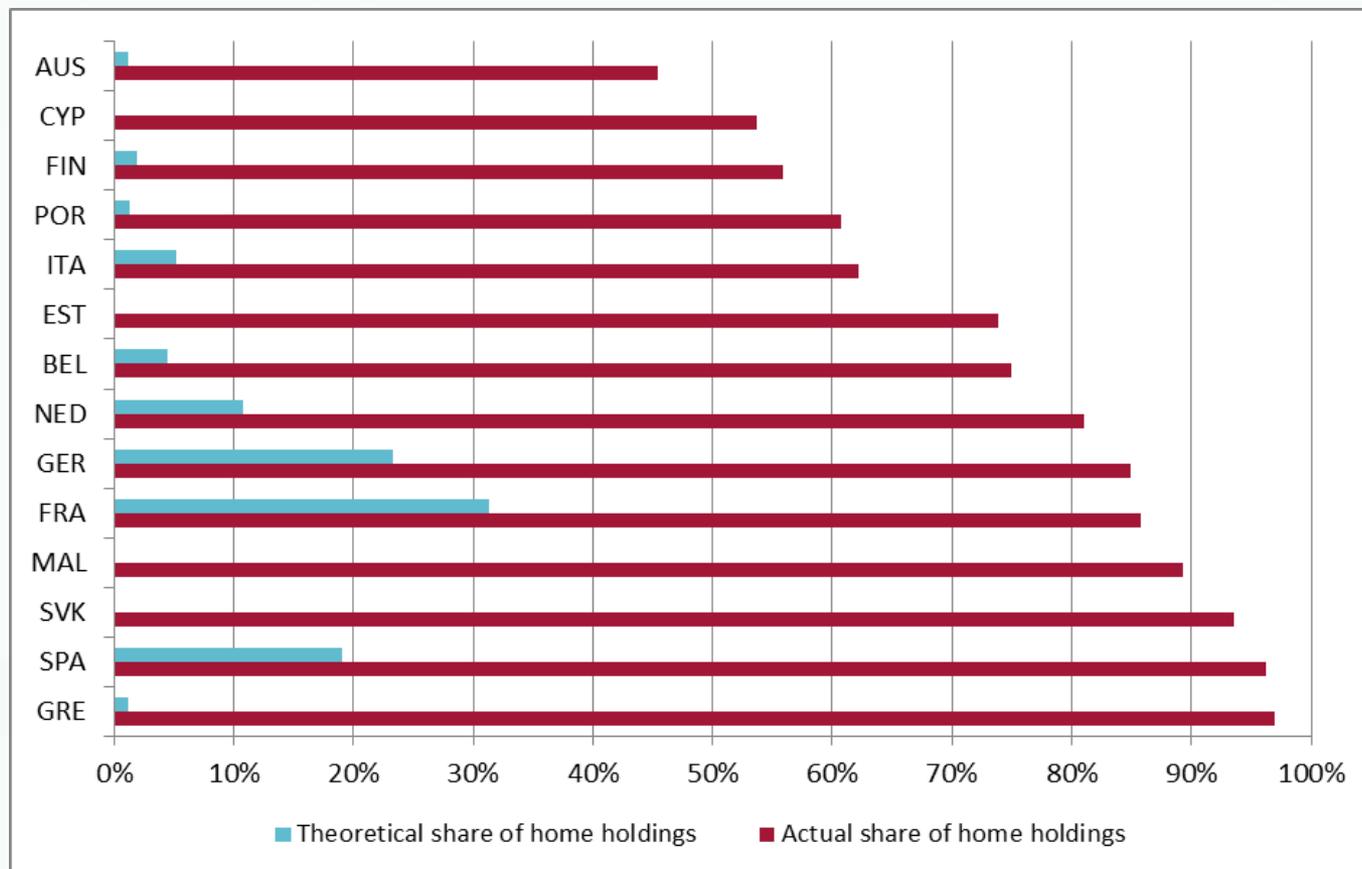


Source: Bruegel based on ECB data.

Financial Union: Banking Union and CMU

3) Equity markets: remain characterised by a strong home bias.

Proportion of equity held in the euro-area countries of domestic origin, 2010



Source: Bruegel based on World bank data on stock market capitalisation and IMF CPIS data on cross-border holdings following Balta and Delgado (2009).

Financial Union: Banking Union and CMU

Véron and Wolff (2015):

- Because of the structure of financial systems → CMU is **no quick fix** to repair bank-lending channel
- Two objectives (enhancing capital markets development and fostering cross-border financial integration) might require different policies
- SME funding will **not** be directly impacted by CMU
- Deeper and more integrated capital markets should spread economic risk, but **potential financial stability risks** need to be managed (→ supervision (ESRB?))
- All member states will gain from better access to finance, but **agglomeration effects** will intensify.

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)

Fiscal union?

- **The key issue is not so much risk-sharing but rather coordination so that**
 - spillovers taken into account and
 - aggregate fiscal stance is appropriate for the euro area
- **Federations have solved this huge coordination issue with centralisation of large parts of fiscal policy in the hands of the federal government, yet...**
- **...this goes to the heart of democracy and legitimacy as it is about spending significant resources.**

Fiscal union

- **Current attempt to solve coordination problem: all countries agree on fiscal rules that are „smart“**
- **But complete contract impossible to write. Rules have numerous problems.**
- **Fiscal policy requires decision making and national authorities increasingly do so...**
- **...undermining quest for coordination**
- **...European Commission exercising discretion, raising question of legitimacy!**

- **New advisory European Fiscal Board has been created:**

- Overview implementation of rules
- Provide opinions on fiscal stance

→ **Stage 2?: Eurosystem of Fiscal Policy**

- composed of a euro area finance minister and his board as well as national ministers:
- mandate: sustainability and fiscal stance
- Giving voting power also to the center in exceptional times
- Euro area chamber of European Parliament to approve decisions in exceptional times rendering them binding
- power to activate fiscal resources of a fund (ESM)

Accountability, Legitimacy, Institutions

- **Wide issue, at the core of the entire discussion**
- **Fiscal legitimacy is national, yet national fiscal policy leads to suboptimal results with negative effects on others → Readiness to change that?**
- **Exercising discretion at European level requires legitimacy.**
- **Report fails to reflect on role of non-EA countries**

Thank you for your attention!

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References:

Sapir, André and Wolff (2015). 'Euro area governance: What to reform and how to do it'. Bruegel Policy Brief, 2015/01

Véron, Nicolas and Guntram Wolff (2015). 'Capital Markets Union: A vision for the long term'. Bruegel Policy Contribution, 2015/05