

Deepening Integration in EMU

Goal: Confidence of public & Credibility of the law

⇒ AAA Union

- Political economy
 - Institution building behind “veil of uncertainty”
 - ...separate from crisis resolution
 - Manage expectations/time frame/scope
- Economic:
 - Hard budget constraints, minimise externalities
 - Growth

= > Coordination of fiscal, financial and economic policies in line with requirements of successful monetary union

„Theory“

- Currently between federation (trade, money, competition) and confederation (national & „shared“ responsibilities)
- Centralisation
 - Economies of scale and externalities
- Subsidiarity
 - Preference asymmetry, legal systems/switching costs, political competition/capture/policy errors

Pitfall: Optimal allocation vs bureaucratic expansion!

Need for EMU long-run vision

- Long-run vision for EMU institutional architecture necessary to ensure consistency of short-run measures
 - Centralisation?
 - Common defense and foreign policy
 - Common government and budget
 - Decentralisation ?
 - Sectoral policies with binding and enforceable governance framework / strong market mechanism
 - Regional/structural/cohesion funds?

What to do in coming years?

- Build on existing three-pronged strategy
 - Implement existing framework and develop institutions (fiscal, economic, financial)
 - Reform countries
 - Safety nets while maintaining solvency of euro area

Fiscal union: pro hard budget constraints-pro growth

- Implement existing provisions (notably Art 126, 6-Pack, soon 2 pack; fiscal compact)
- Strengthen implementation capacity
 - Finance Commissioner decides without college
 - Right to reject budget not consistent with SGP & fiscal compact
 - Personally: Committee that evaluate Commission
 - Abolish Article 126(10)

Euro area budget?

- Spending needs to be affordable, effective and efficient
- Public spending near 50% of GDP (unlike US or Switzerland in 19th century...)
- No new functions of state needed
- Stabilisation via automatic stabilisers & ECB/banking union significant
- Rewarding reforms has pros and cons

Pit falls of stabilisation facility

- Measurement problems (trend growth & output gap)
→ policy errors, divisions
- Fine tuning problems
- Time consistency + capture/political economy
- Affordability (2% = 200bn!)

- Why not structural reforms of labour and product markets?

Economic union: pro growth

- Common market in factors and products
- Personally: minimum wage flexibility standards (but risky)
 - No indexation
 - Opening clauses for sectors/regions/firms
- Would more money and „right to work“ initiatives really help?

Financial Union: pro hard budget constraints—pro growth

- Supervision
 - Common rule book, common supervision with governance independent from ECB
- Moral hazard and “diabolic loop”
 - Large exposure limits including countries, risk weighting of government bonds
 - Role for ESRB and ECB’s 2nd pillar
- Resolution framework with
 - Bail in, hierarchy
- ESM financing
 - Can not deal with legacy debt
 - Should not create moral hazard (bail in, credit standards, foreclosure, euro area budget constraint)

How to get a BBB/CCC Union

- Soft budget constraints via
 - Deficient fiscal rules
 - Eurobonds
 - Private debt mutualisation
 - Federal borrowing
 - Monetary financing
- Anti-growth policies via
 - More dirigisme and red tape
 - Ineffective and unaffordable public programmes