

THE 5 PRESIDENTS' REPORT

– PROPOSALS & CHALLENGES

Prepared for EUI's ADEMU Working Group (17.9.15)

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Agenda

- Snapshot of the 5 Presidents Report (5PR)
 - Background
 - Content
 - Proposals
- Discussion: Proposals and shortcomings of the 5PR regarding fiscal integration and EMU governance
 - Which proposals seem insufficient or uncondusive?
 - Which challenges remain unaddressed?
 - Which conflicts are inherent to the proposals?

5PR – Background

- Euro Summit October 2014:
 - “closer coordination of economic policies is essential”
 - “develop concrete mechanisms”
 - “prepare next steps on better governance in Euro area”
- “Towards a Genuine Economic and Monetary Union” (4PR/van Rompuy Report; 2012) and “Blueprint for a Deep and Genuine EMU” (2012)
- Analytical Note (2015)

5PR – Content

- **Where is the EU/EMU now and how did it get there?**
- Identify need for **progress at four frontlines**:
 - Economic Union: Convergence, Prosperity, Cohesion
 - Financial Union: Banking Union (private risk sharing)
 - Fiscal Union: Fiscal sustainability and stabilization (public risk sharing)
 - Political Union: Accountability, Legitimacy, strong institutions
- **3-Stage Reform Process** (see next slide)
 - “Deepening by doing”: First steps, need to be done now. Use existing treaties, competitiveness, convergence, BU, enforce fiscal rules, democratic accountability
 - “Completing EMU”: post mid 2017
 - Make convergence binding using legal benchmarks, shock absorption mechanism/ stabilization mechanism for complying members
 - Final Stage: by 2025
 - EMU has become “stable and prosperous place”
- **White paper in 2017**: Progress assessment of stage 1 and outline measures for stage 2 (“expert consultation group”)

5PR – Content: The 3 Stage process

- **“Deepening by doing”**: **Emphasis is on structural reforms**
 - Competitiveness authorities, Stronger MIP, Reforming labor markets, Stronger coordination, Agree on high level standards
 - Create and work towards single financial, capital and banking market with common supervision
 - Strengthen 6/2 pack by advisory European Fiscal Board: Aim is to coordinate, complement national fiscal councils and to increase compliance
 - Increase accountability and participation
- **“Completing EMU”**: **post mid 2017**
 - Make convergence binding using legal benchmarks, shock absorption mechanism/stabilization mechanism for complying members
 - Stabilization mechanism aims to help absorb large shocks. “Exact design requires more in-depth work”/”expert group”
 - Embed ESM into EU law
 - Strengthen institutional role of Euro Group (mandate, full-time presidency)
 - Euro Area treasury for collective decision-making on “some decisions”
- **Final Stage: by 2025**
 - EMU has become “stable and prosperous place”

5PR – The 3 Stage process in detail

- “Deepening by doing”: Emphasis is on structural reforms: More efficient markets/public institutions
 - Competitiveness authorities: Independent national body tracking performance/policies regarding competitiveness: Monitor wage-productivity relation and reforms affecting it; EMU wide coordination and feeding of findings into MIP via Commission
 - Stronger MIP: Use Corrective arm “forceful” to tackle imbalances via structural reforms and external deficits/current account surpluses
 - Employment and social performance: Boost employment by reforming labor markets (taxation, protection, unions, pensions, mobility, etc.)
 - Stronger coordination: CSRs more concrete and ambitious but also political, strengthen accountability, integrate them into EMU dimension, more emphasis on long-term goals
 - Agree on high level standards (labor markets, competitiveness, business regulations, public sector) which ensure convergence and make them binding by relinquishing national sovereignty
 - Create and work towards single financial, capital and banking market with common supervision (i.e. limit national discretion), resolution (including fund with common backstop) and deposit insurance. Increase role of ESM in bank recapitalization.
 - Strengthen 6/2 pack by advisory European Fiscal Board: Aim is to coordinate, complement national fiscal councils and to increase compliance
 - Increase accountability and participation: Economic dialogues within dedicated time-slots of Semester, debates between Commission and EP about AGS and CSR, increase role of EP in institutional work, connect Commission closer to national parliaments, consolidate external representation, make crisis arrangements EU law. Reinforce role and tools of Euro Group.
- “Completing EMU”: post mid 2017
 - Make convergence binding using legal benchmarks, shock absorption mechanism/stabilization mechanism for complying members
 - Stabilization mechanism aims to help absorb large shocks. “Exact design requires more in-depth work”/“expert group”
 - Embed ESM into EU law
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5PR – Proposals

- End the Maastricht Consensus: **From “rule based cooperation” to “sovereignty sharing within common institutions”**
- **Enforce existing agreements** more forcefully
- Risk sharing:
 - Short-term: **Strengthen private risk sharing** via Banking Union (SSM, SRM, Resolution fund)
 - Medium-term: **Launch public risk sharing** (“mechanism of fiscal stabilization”) via a new fiscal institution to be outlined in detail, i.e. revenue, spending, conditions
- **Euro area treasury** for collective decision-making regarding “some decisions” while taxation and budgets remain at the national level

Discussion – Hypothesis 1

- The notion of a “**complete**” **Economic and Monetary Union is not well-defined**. Specific targets and criteria are required.
 - Is there a golden rule of integration?
 - Can single countries (US, IT, DE, UK, ...) serve as benchmarks when fiscal transfers “not foreseen” and cannot be permanent
 - What form of public risk sharing/shock absorption mechanism is referred to in Stage 2? In other words, how exactly do member states get into the “Final Stage”? (the land of motherhood and apple pie). A lot of in-depth work necessary.

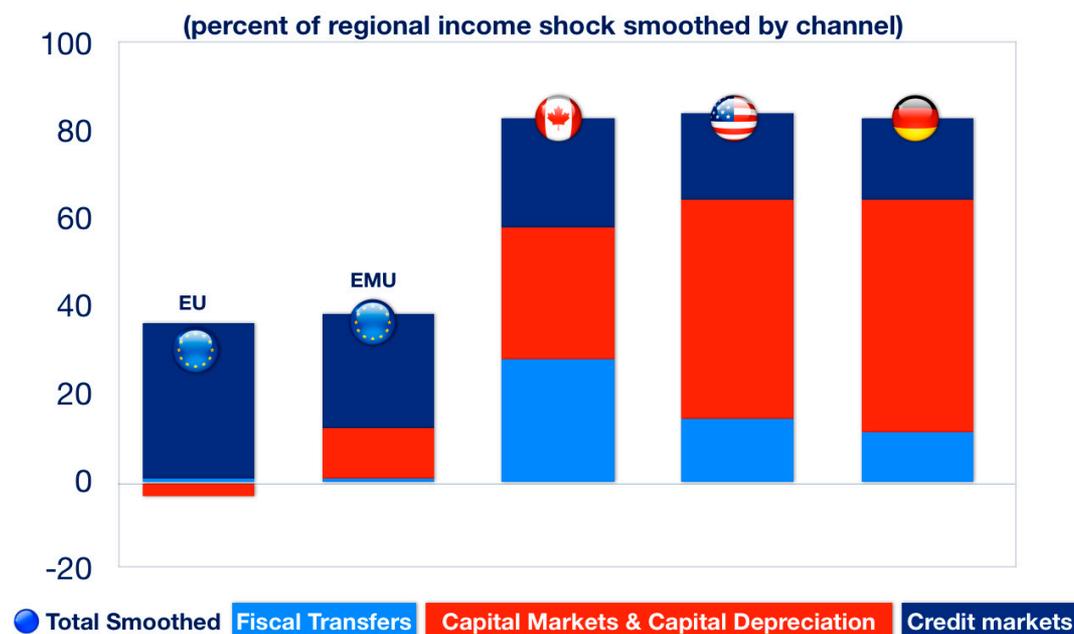
Discussion – Hypothesis 2

- The 5PR identifies **national sovereignty as a constraint to convergence and stability**. Moving from common rules to common institutions necessarily reduces it.
 - What are the problems created by national sovereignty?
 - Would common institutions create even more severe problems?
 - How binding are legal agreements between national states (i.e. a national electorate) and a collective community, i.e. what are punishments for non-compliance?

Discussion – Hypothesis 3

Figure 6. Risk Sharing

Insurance against income shocks in EMU remains low.



SOURCES: Hepp and von Hagen (2012) for Germany; Sorensen and Yosha (1998) for the United States; Balli, Basher and Rosmy (2011) for Canada; and Afonso and Furceri (2008) for the Economic Monetary Union and the European Union.

Discussion – Hypothesis 3

- PRIVATE risk sharing: **shock absorption and fiscal neutrality**
 - Is a common deposit insurance system superior to a national one?
 - Is a common deposit insurance system superior to a union wide re-insurance of the national deposit insurance schemes?
 - How can moral hazard be avoided concretely? (cf. evidence from US)
 - Can ESM bank recapitalization break the bank-sovereign loop?
- PUBLIC risk sharing via **fiscal institution**:
 - There is a target conflict between more convergence and more risk sharing. Can the fiscal union set its emphasis on risk sharing (not on convergence; see guiding principles) exclusively?
 - Which type of risk should it tackle? Individual or national level? (Common unemployment insurance or “deficit insurance?”)
 - How to raise revenue for it?

Discussion – Hypothesis 4

- **A Banking Union instead of Fiscal Union:** “With a well functioning BU there is no need for a fiscal union (and hence no need for political union)!” (Gros, 2013)
 - Banking Union needs: Common Supervision, Common Resolution (including fund), Common Deposit Insurance
 - Loss absorption capacity of this system much higher – reduces need for (fiscal) injections
 - Evidence: Comparison of Nevada-Ireland, Spain-Florida
 - Role of institutions:
 - Common shocks: Response by ECB/ESM
 - Country shocks: Industry financed funds (Resolution fund)
 - Role of national fiscal policy: Respond to cycle

Discussion – Hypothesis 5

- The 5PR is contradictory on the **legitimacy of the fiscal union/EMU governance proposals**
 - Pareto improvement at every junction towards European integration (“bargain” from which all have to benefit) or “common destiny” community?
 - Raises fundamental issue: What are the sources of legitimacy of the fiscal union?
 - Input: “Government by the people” (based on consent)
 - Output: “Government for the people” (based on usefulness/outcome)

Discussion – final hypothesis

- Competitive Authorities are a classical case of **Hayek's local knowledge problem**
 - How can “competition as a discovery procedure” be maintained in a system with global to local directives?
 - How can national states continue to experiment, i.e. discover best and better practices?

Some observations

- End of the rule based system?
 - “Political character” of current commission and “flexibility communiqué” go against it (the latter is a no to a stronger MIP)
 - But the **crisis measures strongly reconfirmed it**
- Some measures in stage 1 and legally binding standards in stage 2 require changing the EU treaty.
 - This means unbundling a lot of highly complex/debated/controversial topics once again (e.g. TTIP).
 - There is a broad consensus that it **won't happen anytime soon.**
 - Is post mid 2017 far away enough?