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"EMU: long-term matters are urgent matters"

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***Synthesis of the presentation of the report of the Tommaso Padoa-Schioppa Group,* Completing the Euro - A road map towards fiscal union in Europe.**

The event took place in Brussels on 9 July 2012. It started with an opening speech by António Vitorino, president of Notre Europe *and member of the Padoa-Schioppa group. After these introductory remarks, Henrik Enderlein, general coordinator of the group, presented the report to the audience. This was followed by an exchange between four members of the Padoa-Schioppa group (Henrik Enderlein, Jean Pisani-Ferry, Maria João Rodrigues and André Sapir) and the audience. The exchange was chaired by Anton La Guardia, European Union correspondent of* The Economist *and "Charlemagne" columnist.*

In his opening speech, **António VITORINO** explained to the audience the origins of the Tommaso Padoa-Schioppa group. The group was set up by *Notre Europe* in December 2011 in honour of *Notre Europe*'s former president, Tommaso Padoa-Schioppa, who passed away in December 2010. Composed by a small number of leading experts having different backgrounds (economists, legal experts) and nationalities, the purpose of the Tommaso Padoa-Schioppa group was to reflect on the structural changes needed to render the EMU sustainable and resilient in the long-term.

A. Vitorino defined the final report delivered by the group as both ambitious and pragmatic: ambitious because it invites the reader to go beyond the short-term urgencies and think on what is needed to secure the euro in ten or fifteen years, but pragmatic at the same time because it takes into account current political and legal constraints and only proposes those reforms necessary to ensure the survival of the euro (as the report itself says, "not more, not less."). According to A. Vitorino, the Padoa-Schioppa report can be an important source of inspiration for the Van Rompuy's "road map", to be presented by the end of the year at the European Council.

Henrik ENDERLEIN briefly described the content of the report. After a comprehensive analysis of the root causes of the crisis, the report identifies three key challenges to the functioning of the Euro area and proposes policy action in various areas to solve these challenges. The **three challenges** are:

- The primacy of the real interest rate effect over the real exchange rate effect, which leads to excessive and persistent cyclical divergences among EMU countries;
- The risk of "self-fulfilling solvency crises";
- The problems derived from the existence of financial markets largely European and highly interconnected and a system of banking supervision and banking resolution eminently national.

To address these challenges, the report proposes **policy actions** in four areas:

1. Deepening the **single market** in order to allow the real exchange rate channel work more effectively.
2. Setting up a **cyclical stabilisation insurance fund** to counter-balance the pro-cyclical effect of the ECB action. This insurance fund would operate outside the EU budget and would work in a largely automatic fashion: countries would pay into the fund in good years and would receive temporary help from the fund when being in a downturn. The ultimate purpose of the fund would be to facilitate processes of internal devaluation.

3. Creating a **European Debt Agency (EDA)** to ensure access to bond markets for sovereigns in crisis time in exchange for a stepwise transfer of sovereignty. Inspired by the principle "sovereignty ends when solvency ends", the EDA would serve as normal financing instrument for an amount of 10% of GDP to all EMU countries and would propose access to additional funding for countries under market pressure in different tranches (20%, 20-30%, 30-40%) submitted to increased degrees of conditionality. A country requiring more than 60% of its GDP to be financed through EDA would have to accept a major transfer of budgetary sovereignty, or otherwise go to an orderly debt restructuring. The EDA would be headed by a "Euro area finance minister".
4. Setting up an **EMU banking union**, with the establishment of an EMU single banking supervision authority and the creation of a European banking deposit fund having also crisis resolution capacities.

While some of these measures can be implemented under the current Treaty, others require far-reaching institutional and legal changes. In particular, the creation of EDA would require not only the establishment of an EMU finance minister but also the setup of a new body capable to ensure the democratic legitimacy of EDA. In this respect, the report proposes the establishment of a joint committee composed of 34 members of the national parliaments and 17 MEPs in charge of controlling the EDA action, and the signature of a new Intergovernmental Treaty at 17 to introduce these changes.

H. Enderlein stressed the fact that all these proposals should not be seen as "à la carte" but as forming part of a coherent "package". This does not mean that there is no room for political bargaining. The proposals from the report reflect different interests and political affinities; some respond to Northern European demands, others to Southern Europe demands; some are traditional right-wing demands whereas others are closer to the left-wing sensitivity. In this respect, compromise solutions are possible.

After the presentation of the report**, Anton LA GUARDIA** posed some questions to the panellists and took some questions from the floor. The exchange between the speakers and the audience centred on the following topics:

1. Evaluation of the 2012 June European Council's results

The members of the group were asked to evaluate the results of the 2012 June European Council, in particular with respect to the progress made with banking union. **Jean PISANI-FERRY** saw the elements outlined on banking union in the June European Council as fundamentally sound. However, he noted that financial markets have doubts about what EU leaders have in mind when talking about "banking union", partly as a result of a vague wording in the European Council's conclusions and partly due to the failures of communication following the European Council. Indeed, if you interpret that banking union is all about the supervision of major systemic banks, noted J. Pisani-Ferry, certainly you arrive at the conclusion that this is not going to address the fundamental problems we are now confronted. He however is convinced that this interpretation is not the correct one, and that what has been discussed and decided goes much beyond than simple supervision.

To **André SAPIR**, what is important about the June EU summit is the late recognition about the nature of the Euro area crisis. He noted how unfortunate it is that the crisis started in Greece, as this has focused the attention during two years on the fiscal nature of the crisis – which is certainly an important component of the Greek situation but not significant for many other EMU countries. Indeed, the crisis stated in 2007-2008 as a financial crisis. Had the EU leaders reacted in 2009 by putting into place a "banking union", we would have avoided much of the problems we are facing today, including Greece.

For **Maria João RODRIGUES,** what is remarkable from the June European Council is the first time recognition of the need to have a long-term plan for the EMU. In this respect, the Van Rompuy mandate to develop a specific and time-bound road map is very important and the Tommaso Padoa-Schioppa report can provide a valuable input to this work. M. Rodrigues described the current situation as being in a half-way, with some pieces already in place (reinforced rules on fiscal discipline, strategy for growth) but other relevant pieces of the puzzle still missing (lack of instruments to ensure access to credit to private actors and reasonable borrowing costs for sovereigns).

2. ***Opinions on German economic thinking***

The members of the group were also asked to give their opinion on the German economic thinking which is currently dominating many spheres of power in Germany.

According to **Henrik ENDERLEIN**, there is no single "German economic thinking" but one type of economic thinking in Germany which receives a lot of attention from the media. This thinking is based on two basic beliefs, one of them is very German (the belief on rules and sanctions as a way of ensuring the good governance of EMU) but the other is not inherently German (the idea that "we did an agreement and this agreement is not kept, and now we have to pay for that"). Above all, he noted, what happens today in Germany is that people fear they will have to pay without an appropriate quid-pro-quo. In this respect, the Tommaso Padoa-Schioppa report proposes a fair "quid-pro-quo" deal: countries in trouble should be ready to accept a loss of sovereignty in exchange for help. This makes the proposal much more acceptable to Germans. Finally, H. Enderlein criticized some of the debates taking place in Germany for being "bad economics" as they only focus on the costs of saving the euro but do not take into account the costs of an Eurozone break-up (*"there is one cost side missing in the German equation, it is bad economics if you do not include the other cost"*).

For **Jean PISANI-FERRY**, one should not forget that what is happening is in part a German nightmare becoming reality. He expressed sympathy for something that Germany has brought into the debate; the focus on consistency between the principles and short-term actions (the idea that *"if you do something today for fighting the fire, you should think what the long-term consequences are and how consistent is the short-term action with your principles"*). However, he criticized the simple German view that most of the problems come from a lack of enforcement, neglecting the failures in the design of the rules. He also expressed his lack of sympathy for economists who discredit themselves as scientists, falling into populism. According to J. Pisani-Ferry, the task of economists should be to think and inform the public and not to nurture the public opinion's angriness towards the potential distributional consequences of the crisis.

3. ***EMU heterogeneities and current account imbalances***

There was a question on whether it would be necessary to complement the measures proposed by the report to address EMU heterogeneities with some kind of EMU-level mechanism to ensure a symmetric adjustment of current account imbalances (in particular, a mechanism to force Germany reduce its current account surplus).

For **Henrik ENDERLEIN**, the idea of establishing a top-down mechanism to force a country to reduce its current account surpluses is unrealistic. You cannot steer an economy in a direction in which it exports more or less, he argued, this has to be left to the market. All you can do is to try to stimulate domestic consumption. However, the logic in the Padoa-Schioppa report is that, in a well-functioning currency area, this should come automatically. And indeed, he noted, this is what is happening today: Germany is now facing negative real interest rates and, as a result of this, there is an increase in asset prices, people has the perception they are richer, and wages are increasing too (there has been a rise of 6% in large areas of German industry). This naturally leads to more domestic consumption.

4. ***The European Debt Agency (EDA)***

The discussion also focused on the particularities of the European Debt Agency. There was some debate on whether the existing European Stability Mechanism (ESM) could serve as "embryo" of a future EDA. Both **Henrik ENDERLEIN** and **Maria João RODRIGUES** pointed out the difficulties of thinking on a precise road map in an evolving and changing context (*"the ESM today is not the same that the ESM two weeks ago"*). They nevertheless agreed in principle on the possibility of moving from ESM to EDA. However, as H. Enderlein alerted, a transition from EMS towards EDA would require introducing the principle of "joint and several liabilities", something that for Germany would be a quite far reaching step and would probably require a referendum. In any case, a transition from ESM to EDA would not spare us from the need to create a democratic control to EDA, and thus to sign a new Intergovernmental Treaty.

Jean PISANI-FERRY was asked about the possible compatibility between Bruegel's blue/red bonds proposal and the EDA. He argued that the blue/red bond proposal was conceived as a permanent regime device for the very long term, whereas the EDA is a solution for the medium term. He stressed that the EDA is similar to the blue/red bond scheme in that it combines joint and several guarantees with an incentive/penalty element. However, it is more gradual, and thus more adapted to deal with crisis situations. Instead of having a threshold, it proposes different possible thresholds, with less conditionality in the first tranches but a loss of sovereignty in the last tranche.

5. ***Banking union***

Asked to elaborate on the fiscal backstop for the "banking union", **André SAPIR** pointed out that an EMU banking union inevitably requires some degree of "fiscal union". It should be as much as self-financed as possible (that is, through contributions coming from the banks) but it is clear that, in the event of a major systemic financial crisis, you will need to call upon the taxpayers. In a single country, this will be relatively easy but in a union of countries this poses a problem. To avoid disputes, you need to design an implicit fiscal backstop, in form of "ex ante" arrangement for burden-sharing among national taxpayers.

6. ***Monetary policy***

The members of the group were asked about the absence of proposals on monetary policy in the Padoa-Schioppa report. They were also asked to give their opinion on the possibility to use asymmetric ECB tools (i.e. credit lines) to help crisis countries, as well as on the proposal to give a banking license to the ESM. **Jean PISANI-FERRY** alerted on the dangers of using monetary policy to address Euro area divergences (*"differentiating monetary policy would basically mean that the very notion of a single monetary policy is questionable and that we try to mimic different monetary policies. I would be reluctant to go on this direction"*). **Henrik ENDERLEIN** expressed his opposition to any type of involvement of the ECB into the rescuing of countries. According to him, the ECB can and should act as a short-term lender of last resort in case of urgency, but it is not in charge of rescuing countries, which is a political matter subject to parliament ratification.

7. ***Institutional and legal framework***

There was some debate on the institutional and legal implications of reforming the EMU. The members of the group recalled their conviction that a full reform of EMU would require the signature of a new Intergovernmental Treaty among the 17 Euro zone member states. **Maria João RODRIGUES**, however, alerted on the need to eventually accommodate this new Treaty with the existing Treaties (*"ultimately we will be confronted to reform the Lisbon Treaty itself"*).

Both **Henrik ENDERLEIN** and **Jean PISANI-FERRY** highlighted the need to eventually develop a clear legal and institutional separation between the EMU and the EU framework. The Maastricht Treaty was drafted under the assumption that all EU countries will ultimately join the euro, and still now EU countries have the legal obligation of entering into EMU, something which appears totally nonsense at a moment when the crisis has shown the potential costs of participating into the Euro. Besides, the lack of separation between the framework of EMU and EU has led to some paradoxical situations, such as the fact that the president of the ECB is interrogated at the Economic and Monetary Affairs Committee of the European Parliament by MEPS from non EMU countries.

8. The political strategy to reform EMU

There was some debate about what would be the best political strategy to advance the reforms proposed by the report. According to **Maria João RODRIGUES**, a "big bang" is very improbable. It is therefore more realistic to advocate for a step-by-step approach, with more ambitious steps and a clear end-point**.** She stressed the need to define a long-term goal in order to take the right decisions in the short term (*"we need short-term solutions designed with a long-term perspective"*). **Jean PISANI-FERRY** pointed out the need to insufflate credibility to the whole process. Credibility does not come from the fact that you pretend resolve all the problems from day to night, but from identifying a clear goal and addressing it through detailed negotiations. He put as example the issue of banking union, which is extremely complicated and full of details. Being credible in this matter is not to pretend we have already a solution but to work on the solution. **André SAPIR** recalled that credibility ultimately requires a real, strong commitment for the long term. As long as EU leaders do not convince the markets that the EMU will remain with its 17 members in the future, the crisis will be very difficult to solve. Finally, **Henrik ENDERLEIN** agreed on the need to define a clear, long-term goal and to move step-by-step towards this goal. This long-term goal must be a compromise between different national positions. Thus, for instance, for Germany it should imply accepting some very limited amount of joint and several liabilities, and for France to accept some loss of sovereignty in the case they misbehave.