SYNTHESIS
12 JANUARY 2018
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#EURO

THE EURO AS A LEVER OF EUROPEAN INTEGRATION

■ SOFIA FERNANDES
Senior research fellow, Jacques Delors Institute

■ EULALIA RUBIO
Senior research fellow, Jacques Delors Institute

The Jacques Delors Institute (JDI) provides a summary of the debate on "The Euro as a Lever of European Integration", held on 9 December 2017 at the Hôtel de l'Industrie in Paris as part of the annual meeting of the JDI's European Orientation Committee.

On the basis of a keynote lecture by François Villeroy de Galhau, Governor of the *Banque de France*, the participants discussed the main steps required to complete the Economic and Monetary Union (EMU). The debate began with a short historical synopsis of the euro (1) and a roundup of the arguments that justify the imperative of completing the Economic and Monetary Union (2). The discussion then focused on four accelerators needed to strengthen EMU: a macroeconomic accelerator (a lending instrument for stabilisation purposes and a European Monetary Fund) (3.1.); a microeconomic accelerator (a Financing Union for Investment and Innovation) (3.2.); a fiscal accelerator (a budget for the Eurozone) (3.3.) and an institutional accelerator (a finance minister and a parliament for the Eurozone) (3.4). Finally, the question was raised whether it was possible to have an Economic and Monetary Union (EMU) without a political union (4).

1. What has the Economic and Monetary Union achieved so far?

François Villeroy de Galhau began by emphasising the accomplishments of the euro, even though some macroeconomic expectations linked to the introduction of the common currency were not met. It was thought that the euro would lead to a strengthening of the single market. In fact, in value terms extra-euro area exports are today greater than intra-euro area exports, according to data presented by the governor of the *Banque de France*. Despite this, it was recalled during the debate that the euro has helped to facilitate competition between firms through better price comparability. It was also anticipated that the euro would lead to greater convergence between Eurozone countries and would boost economic growth and job creation. This convergence did not take place and the performance of the euro area in terms of growth and jobs has been worse than that of the United States. Clearly, despite the monetary union, the performance of the participating states has varied widely, depending on the reforms and economic policies implemented in each country.

Still, according to Villeroy de Galhau, the disappointing record of the economic union does not call into question the success of the euro, which is today a currency trusted by Europe's citizens. This is mainly due to its positive impact on price stability (inflation fell by two thirds in the last 18 years compared to the 18 years prior to the euro), but also to the lower financing costs for states, businesses and households. The crisis notwithstanding, confidence in the common currency remains high and currently stands at 73% in the Eurozone as a whole (the highest score since 2004). In Germany, it rises to 82%, compared with 72% in France. Among Eurozone countries, support for the common currency is lowest in Italy, although even there it retains a majority of popular support (58%).

Villeroy de Galhau credited the EMU with two further achievements. Among the various European bodies, the Eurosystem is arguably the one that works best. There is efficient coordination between the actors in terms of decision and execution. The euro has also led to greater political recognition of Europe on the ever more important international scene. When the President of the European Central Bank (ECB), Mario Draghi, speaks at the G7 or G20, everyone listens with great attention. Thanks to the euro, the EU has the capacity to influence the international economic sphere. Although the objective of the euro's share in global foreign exchange reserves has not been reached, the common currency currently accounts for around 20% of those reserves. Before the introduction of the euro, all national currencies taken together only made up around 13%. The Eurozone and the EU as a whole are stronger when they speak with one voice. To illustrate this point, the governor of the Banque de France cited the example of the Basel III agreement, which would not have been possible without a concerted team effort on the part of the EU. Some participants qualified the successes of monetary union during the debate. It was pointed out that the fixed exchange rates associated with the common currency excluded the possibility of a currency devaluation in the event of a crisis, which in turn left only the option of an internal devaluation and austerity policies. Others responded that this difficulty could have been avoided if a common macroeconomic stabilisation mechanism, as exists in other common currency areas, had been put in place right at the start of EMU. This instrument is still missing in the current architecture of the EMU.

In this respect, Villeroy de Galhau concluded his introductory lecture by underlining the fact that since the Maastricht Treaty was signed 25 years ago, Europe has successfully built a monetary union. However, it has not achieved its goals with regard to the economic union. It was pointed out during the debate that, even before Maastricht, Jacques Delors had put a genuine EMU on the negotiating table, but the decision-makers neglected the economic dimension highlighted in the Commission's proposal. In order to avoid overburdening monetary policy, the EMU must walk on both legs, rather than limp along on one. It is therefore urgent to move forward toward an economic union.

2 . Completing the EMU: why and when?

For Villeroy de Galhau, the two main reasons for completing the EMU are stability and growth. Firstly, it is necessary to limit the impact of a future crisis that would hit a poorly prepared euro area. The architecture of the Eurozone must be completed to ensure its stability. Secondly, Europe must close the growth gap with the United States and finally tackle the scourge of mass unemployment in Europe.

Villeroy de Galhau stressed that we are witnessing a unique historical opportunity for completing the EMU – a view seconded by numerous other participants: "The time to repair the roof is when the sun is shining." Above all, the current economic environment is propitious enough for a breakthrough, as growth in the euro area, estimated to have expanded by 2.2% in 2017, is expected to be at its highest level in ten years, rivalling that of the United States. In addition, although unemployment remains high, the Eurozone has created around 7 million jobs since 2013.

The democratic cycle seems similarly favourable. There is a new government in France and soon, one hopes, in Germany and Italy. There are grounds for cautious optimism, with three years of relative democratic tranquility ahead that should spur the implementation of the necessary reforms. It would be a mistake, however, to believe that this moment will last forever. For many participants in the debate, the window of opportunity for European leaders will be open only for a few months: from the day the new German government assumes office to the upcoming elections to the European Parliament in the spring of 2019.

Finally, the Brexit vote and the election of Donald Trump in the United States functioned as external stimuli, demonstrating the importance of reinvigorating the European integration process so that Europeans take their fate into their own hands, as Chancellor Merkel rightly urged them to do in Munich last spring after returning from a G7 summit.

The completion of the EMU, expressly desired by European leaders in the Rome Declaration of 25 March 2017, will take place now or never. The euro remains the crucial instrument for deepening the EU. Since the Eurozone is an open club, the eight countries outside the common monetary area must not block progress towards further integration of the EMU.

The roadmap for deepening the EMU presented by the Commission on 6 December acknowledges the need to seize the opportunity presenting itself to European leaders. Nevertheless, several participants argued that the Commission's proposals are not ambitious enough, in particular when it comes to the idea of a European Monetary Fund (EMF).

3 . How to reform the EMU?

According to the governor of the Banque de France, the debate on the reform of the EMU is likely to reproduce two old divisions: "German rules" will be pitted against "French spendthrifts", the "community method" against the "intergovernmental approach". In Villeroy de Galhau's opinion, we must leave these old quarrels behind and think about concrete measures to move towards an economic union.

National reforms are a prerequisite for creating an economic union, but they require four accelerators:

- a **macroeconomic accelerator**, comprising a collective economic strategy shared by all euro area Member States and aiming to strengthen the instruments needed to deal with financial crises
- a **microeconomic accelerator** in the form of a Financing Union for Investment and Innovation, which would go further than the Banking Union and the Capital Markets Union
- a **fiscal accelerator** revolving around a Eurozone budget
- an **institutional accelerator** acting as a "facilitator" for the first three, which would include the creation of a finance minister and a parliament for the Eurozone.

The three economic accelerators would contribute to the economic policy functions as defined by Musgrave: allocation, stabilisation and distribution. The allocation function would be covered by the microeconomic accelerator, but also by the fiscal accelerator, through the financing of common goods in Europe. The stabilisation function would be fulfilled mainly by the macroeconomic accelerator, but also by the microeconomic accelerator – because of the improvement of private risk sharing – as well as the fiscal accelerator. Finally, the distribution function would eventually be overseen by the fiscal accelerator. This last function, however, is not essential and would in any case require political agreement.

Villeroy de Galhau proposed to concentrate the efforts initially on the first two accelerators (micro and macro), most of which can be adopted without treaty changes, while leaving for later the last two accelerators (fiscal and institutional).

3.1 ▪ The macroeconomic accelerator: a lending instrument for stabilisation purposes and a European Monetary Fund

The macroeconomic accelerator would involve putting in place a collective economic strategy based on a "reforms / stimulus" agreement: reforms in the countries where they are needed (like France or Italy) and stimulus in the countries with more room for manoeuvre (such as Germany or the Netherlands).

In addition to this agreement, Villeroy de Galhau called for the creation of a supplementary stability mechanism. This would be a lending instrument aiming to support euro area Member States facing a temporary shock (such as Finland in the 2000s). Access to this instrument should be fast and simple – provided the minimum conditions (such as compliance with the Stability and Growth Pact and the pursuit of policies in accordance with the euro area's collective economic strategy) are met – and not be subordinate to the implementation of an adjustment programme.

The Governor of the Banque de France also came out in support of a European Monetary Fund (EMF). However, he warned of the risk of creating an empty shell. The creation of an EMF, he continued, would only make sense if its scope and governance exceeded those of the current European Stability Mechanism (ESM). It should have more prerogatives than the current ESM, and its actions should not be paralysed by veto rights. According to the Governor of the Banque de France, it would also be desirable to anchor the EMF in EU law and to entrust it – in that framework alone – with the task of monitoring compliance with the common budgetary rules.

The floor discussion gave rise to exchanges on the issue of convergence and the role of structural reforms in the deepening of economic union. Several speakers called to mind the difficulty of implementing reforms in the economies of the southern Member States and the "reform fatigue" that befell these countries after several years of adjustment. The possibility of supporting countries implementing reforms from a Eurozone budget was also brought up. It was argued that improving competitiveness does not always depend on structural reforms. Thus, the EU would be well advised to help euro area economies to ring-fence their spending on education and research during crises to avoid competitiveness losses. Finally, some speakers contended that the reforms recommended by the European Commission do not always produce the desired results, particularly in the fight against unemployment and poverty, but also when it comes to social investment. Others have maintained that structural reform is not synonymous with fiscal austerity and that some reforms (such as those pertaining to vocational training in France) can have a rather positive impact on social cohesion.

3.2 ▪ The microeconomic accelerator: a Financing Union for Investment and Innovation

Regarding the microeconomic accelerator, Villeroy de Galhau indicated that the Eurozone has a savings surplus over investment of about 350 billion euros per year, or more than 3% of GDP. Furthermore, there is a large gap between the euro area and the United States in terms of equity financing, which is the key to an innovation economy. The stock market capitalisation to GDP ratio of SMEs in the Eurozone is 73%, while it amounts to 123% in the US. According to Villeroy de Galhau, this gap is worrying and too often overlooked, which partly explains why the EU remains an innovation laggard.

In order to allocate savings more efficiently towards productive investment, the Governor of the Banque de France advocated the creation of a Financing Union for Investment and Innovation. Through unified governance, this Union would foster synergies between already existing initiatives (including the Juncker Investment Plan, the Capital Markets Union and the Banking Union). There is nevertheless a need for new initiatives to make progress in four key areas:

- encouraging cross-border investment through reforms of accounting rules, taxation and bankruptcy laws
- developing Europe-wide long-term savings products and investment vehicles (such as European venture capital funds)
- completing the Banking Union
- monitoring the financial activities and risks that are of vital importance for the euro area, such as super-systemic central counterparties.

The proposals for the microeconomic accelerator attracted a lot of interest from the audience. During the floor discussions, it was asserted that, on the way towards a Banking Union, a delicate balance between risk sharing and risk reduction must be struck. Taking up this last point, Villeroy de Galhau reiterated the importance of addressing the issue of bad debt to reduce risk in the banking sector and of finalising the second pillar of the Banking Union, the Single Resolution Mechanism, by building up the Single Resolution Fund (SRF) and establishing a common fiscal backstop. He was, however, more skeptical about the need and the opportunity to create a European deposit insurance scheme (EDIS).

The Governor of the Banque de France also said that it was necessary to facilitate the cross-border consolidation of banks. According to him, the emergence of large pan-European banks would promote a better distribution of risk throughout the euro area, while also directing savings more efficiently towards productive investment opportunities. In this respect, the Eurozone is lagging behind, for in the United States the top five banks hold more than 40% of market share, compared with around 20% for the top five banks in the Eurozone.

3.3 ▪ The fiscal accelerator: a budget for the Eurozone

According to Villeroy de Galhau, the fiscal accelerator is the most delicate, since it may well conjure the "spectre" of a transfer union. Its implementation necessitates a tremendous persuasive effort and should only be envisaged after the other two accelerators described above will have been successfully implemented.

In current discussions about the euro area, views on what should constitute a Eurozone budget diverge widely. The Governor of the Banque de France did not comment on the size, structure and composition of a possible common budget, but insisted that such a budget would be necessary both to cushion the impact of crises (stabilisation function) and to ensure the proper funding of common goods in Europe (allocation function). He was in favour of introducing this new budget outside the EU budget rather than inserting it as a program or budget line in the budget of the 27 Member States, as the Commission intended.

In the floor discussion, several speakers alluded to the importance of linking these reflections on the Eurozone budget to the ongoing debate on the next Multiannual Financial Framework (MFF). The negotiation of the MFF will begin in spring 2018 and likely result in charged debates given the hole that Brexit will tear in European public finances.

A discussion about the notorious German taboo of the transfer union ensued. For some speakers, it would be necessary to tackle this taboo, for the EU is in effect already a transfer union. The goal should not be to avoid transfers but to think about the best way to organise them.

Some speakers then recommended thinking carefully about how to finance this new budget. The creation of a Eurozone budget could be an opportunity to move towards common taxation schemes in areas consistent with EU priorities, such as the energy transition (with a European carbon tax) or the creation of a digital single market and the fight against unfair tax competition (with a European tax on large multinationals in the digital sector, the so-called GAFA: Google, Amazon, Facebook, Apple).

3.4 ▪ The institutional accelerator: a finance minister and a Eurozone parliament

Villeroy de Galhau affirmed that the three economic accelerators cannot function effectively if they are not accompanied by a distinct governance structure including a finance minister and a parliament. Moreover, decisions on EMU must be subject to genuine parliamentary scrutiny, which in one way or another must involve national parliaments. This idea was endorsed by many participants. In addition, attention was drawn to the fact that national parliaments, too, must be able to exert greater control over their government.

In the discussions with the audience, several speakers expressed their skepticism about the European Commission's proposal to create a European finance minister. For some, the political and institutional changes are not a priority, and should come after, not before major issues concerning the deepening of the economic union have been settled. For others, the creation of such a minister without giving it real powers, while potentially generating false expectations, would be mere window-dressing.

4 ▪ Is EMU conceivable without political union?

Whether the common currency is conceivable without a state backing it is a question that has been debated since the conception of EMU. Already in Maastricht, many skeptics (especially on the other side of the Atlantic) declared that a currency without a state would not work. For Villeroy de Galhau, it is possible to have a common currency without the EU morphing into the United States of Europe, provided that the institutional European environment is strengthened.

It is first and foremost mandatory to realise visible projects with tangible achievements for citizens at the European level. To this end, it may be better to do fewer things with better financial means to ensure their completion, which would yield tangible results in the eyes of European citizens. According to the governor of the Banque de France, these initiatives could include defence projects, the fight against climate change or – in light of a situation where in some countries many young people are unemployed, while other Member States have job opportunities for them – an ambitious mobility initiative for apprentices, the Erasmus Pro, as proposed by the Jacques Delors Institute in 2015.

In addition to these projects, the European environment must also be reinforced by a shared sense of identity. 19 EU countries currently have the same currency, 27 are part of the single market and all share a European social model, which often goes unmentioned. Although differences between national social models remain, there is indeed a European social model making possible high-quality public services, especially in health and education, levels of inequality well below those seen elsewhere in the world (according to the Gini index) and a culture of intense social dialogue. During the floor discussion, participants said that EU Member States must strive not only to preserve this European social model, to which citizens are attached, but also to modernise it given the challenges it faces, including globalisation, an ageing population or the digital transition. The European Pillar of Social Rights, adopted at the Gothenburg Social Summit in November 2017, is an instrument waiting to be used. It is necessary to establish priorities among the 20 principles laid down in the European Pillar of Social Rights, and to concretise them through legislation, coordination and/or European funding.

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Managing Editor: Sébastien Maillard Translated from the French by Danilo Scholz ▪

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PREMIER MINISTRE

19 rue de Milan, F – 75009 Paris
Pariser Platz 6, D – 10117 Berlin
info@delorsinstitute.eu
www.delorsinstitute.eu