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Completing The European Monetary Union properly



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The European Economic and Monetary Union and the introduction of the euro are two milestones of European integration. The single currency is a visible and tangible sign of the convergence of the Member States of the European Union (EU). At the same time, this step towards integration was also an answer to globalisation, with the aim of enabling citizens of the EU, today and in the future, to live their lives in peace and freedom, with self-responsibility, social security and prosperity.

The most important messages at a glance:

- **The European Commission White Paper outlines five scenarios**
- **Boosting competitiveness remains key**
- **Economic policy coordination to be strengthened**
- **Binding and credible fiscal rules have to be implemented**
- **European financial market framework - paying more attention to diversity**

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Completing The European Monetary Union properly

The worldwide economic and financial crisis in 2007/2008 also put the euro area to the test. Since the end of 2009, the euro area has therefore made huge progress to strengthen the pillars of the Monetary Union. The Stability and Growth Pact has been reformed and supplemented by the Fiscal Compact. In this way, for example, budgetary discipline in the Member States has improved, achieving an average public debt to GDP ratio in the euro area of under 90% for 2016. Nevertheless, this figure could be even better, given the good growth performance.

Euro area on the right track

The European Semester ensures better coordination of financial and economic policies. The European Banking Union strengthens financial stability to avoid a repetition of past errors. Overall, the “expansionary” monetary policy of the European Central Bank has bought time for member states. Especially through joint resolute action, we have succeeded in warding off acute threats to cohesion in Europe.

The European Commission White Paper outlines five scenarios

Europe is facing major challenges. It is not only Brexit that has triggered a broad discussion about Europe’s future objectives and the way the continent’s political and economic system is to be designed and shaped.

We therefore welcome the fact that the White Paper on the Future of Europe, published on 1 March 2017, has focused on the launch of the debate on five different scenarios and points out important options.

Scenario 1 “Carrying on” represents a scenario of “muddling through”. With this scenario no fundamental changes take place and problems are tackled where they occur.

Scenario 2 “Nothing but the Single Market” might sound like a very pragmatic approach, as the Single Market is without doubt a huge success story of post-WW European integration.

Nevertheless, the European Union would not meet the global challenges confronting all Member States (such as migration, climate change, security etc.) if it were only to focus on the Single Market.

The Single Market is not an aim in itself but has to serve the interests of market participants to provide access to goods and services for consumers and enterprises. Furthermore, the principles of subsidiarity and proportionality also have to be taken seriously within the area of the Single Market.

Common rules for this market are important; without common rules no single market can exist. But common rules do not mean fully harmonising each and every aspect. Ultimately, all business transactions are concluded on a local level. Even within a single market, local markets still exist and they fulfil important supply functions for the citizens of Europe. Only with a strong regard for and compliance with the principle of subsidiarity, can the best service for the citizens of Europe be achieved.

Scenario 3 “Those who want more, do more” opens the opportunity to move on in specific areas where European cooperation and integration has remained underdeveloped for many different reasons (e.g. security and defence policy), but which are nevertheless regarded as crucial for the well-being of the Member States and the continent as a whole. Attention must be paid to the risk of cherry-picking.

*The most promising strategies
„Those who want more do more“
and „Doing less more efficiently“*

Scenario 4 “Doing less more efficiently” means genuinely focusing on selected common policy areas, while doing less where it is perceived to have no added value. This scenario – especially in combination with scenario 3 – is closest to the guiding principle of the European Union “Europe: Unity in Diversity”. Scenario 4 would be best in line with the preeminent principles of subsidiarity and proportionality that are of vital importance for the further development of the European project.

Scenario 5 “Doing much more together” is the scenario which Commission President Juncker assigns explicitly to the Five Presidents’ Report. This scenario would certainly be asking for too much in too short a period of time. However, in some well-defined areas like security and defence, closer cooperation and to some extent even integration would not only be welcomed but also expected by the citizens of the European Union.

DSGV considers an intelligent combination of Scenario 3 “Those who want more, do more” and Scenario 4 “Doing less more efficiently” as the most flexible and promising way forward.

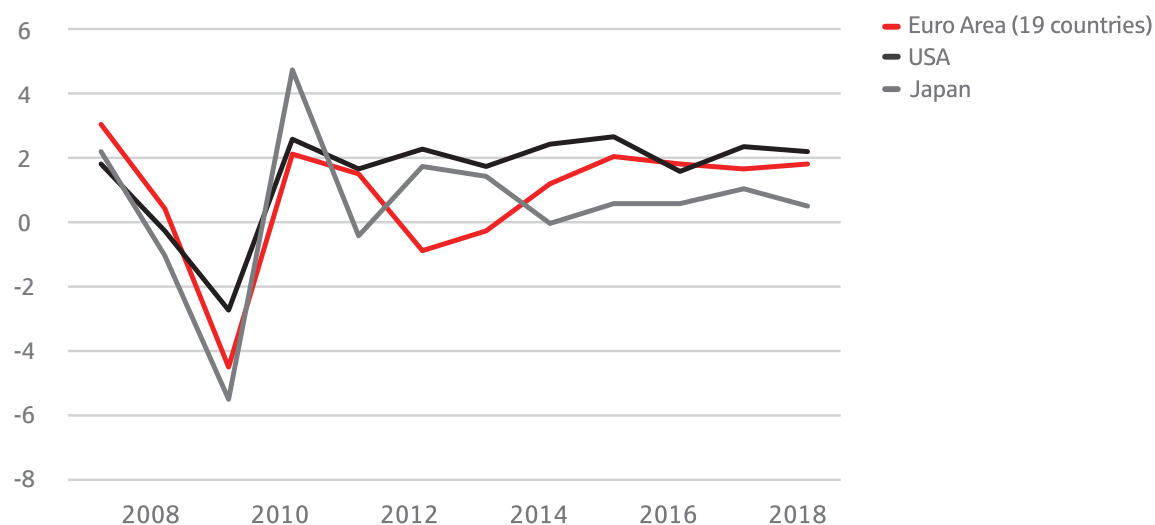
Boosting competitiveness remains key

The key for Europe and its member states generally lies in boosting competitiveness locally, and in further developing the internal market with its four fundamental freedoms (free movement of goods, services, capital and individuals), as well as in more intensive economic policy cooperation between the Member States.

Structural economic and social policy reforms, for example in the fields of labour market, pension schemes, education or sector-specific regulation,

are a prerequisite for sustainable growth and greater competitiveness for all Member States, especially the economically weaker Member States or those reliant on external assistance. Here the Member States must primarily meet the challenge themselves. In addition, the EU Structural Funds should be more focused on supporting these processes. Thus, European and national policies can interlock more effectively.

GDP Growth Rate, in % YOY



Sources: Eurostat, Winter Forecast EU Commission (February 2017), World Economic Outlook IWF

A successful growth policy in turn contributes to a normalisation of interest rate levels. The euro area is progressing well in this respect, as the graph demonstrates.

Growth policy is required

Turning away from Europe is an option with dramatic consequences for citizens and for the economy. Each Member State alone would be overburdened with the challenges of our times. Without the EU, no European country alone could play any kind of significant role at global level. At the same time citizens have to be convinced that, for a sustainable growth and social policy, the national states could reach their limits in certain areas and some challenges can be resolved more effectively at European level. The European Union must emphasise this through specific successes. Only together can the Member States make full and optimal use of the opportunities associated with globalisation and mitigate risks. We must therefore combine forces (climate, digitalisation, refugees, migration are just a few examples of the challenges with which we are confronted).

The focus on the needs of citizens in their regions is a profoundly European approach in this respect. It is especially in the municipalities and local com-

munities – building on the primacy of a public welfare orientation – that the foundation for cohesion in Europe is being created. This must also be taken into consideration by elected representatives in the European Parliament and in the national parliaments (as well as in the European Commission and the Council) – each at their level of competence – and it must be observed in all decision-making processes.

The instruments with which the financial crisis was successfully overcome were decided among the governments of the euro countries, the European Parliament and the national parliaments, in some cases also outside the Union Treaties. A broad parliamentary participation in these instruments is of vital importance. If certain established inter-governmental solutions are to be incorporated into Community law, the democratic participation of the European Parliament must be ensured. This increases acceptance for further steps towards integration.

Scepticism of further far-reaching steps towards reform and integration should not be encouraged. For a functioning Economic and Monetary Union, it is necessary for the euro States to restore greater mutual trust. This includes the reliable application of existing rules. Further development of the European Monetary Union must be guided by the following principles:

Stability and solidity: The “euro area” and the European Union are a community based on stability. It is imperative for stability to ensure the credibility of the Treaties, the implementation of jointly agreed rules and confidence in the European institutions. The European rules of the euro area should above all act to prevent economic and financial crises. Consequently, the solidity of the Member States’ economic and financial policy is indispensable.

Subsidiarity: Stability starts at home. Therefore the individual Member States must be granted as much independence and assume as much responsibility for themselves as possible. First and foremost, each Member State has the obligation to ‘put its house in order’.

Solidarity: The “euro area” and the European Union represent a solidly united community of values. Member States must be able to rely on one another with regard to solidarity and commitment to reforms.

Conditionality: However, solidarity does not work without conditionality. Solidarity requires those receiving assistance to stick to given rules and agreements. Responsibility and liability must not be separated. Without conditionality, solidarity is a one-way street.

The role model for Europe must be the social market economy. It enables prosperity and social welfare as well as serving the people. This must also be

brought to bear even more strongly concerning European economic and financial policy. A triad is necessary to create sustainable growth and prosperity:

- sound finances to avoid leaving behind mountains of debt to future generations,
- necessary structural reforms for greater competitiveness, regional plurality and
- private investment to ensure future prosperity.

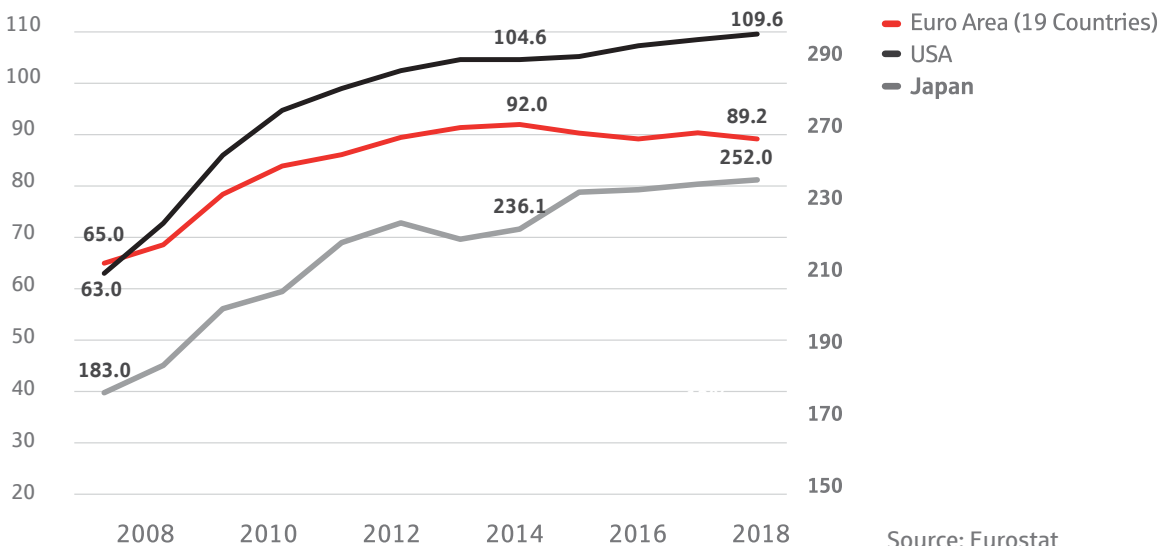
Social market economy for europe

If these principles are applied, a sensible further development of Europe is possible. The euro and the non-euro countries must not drift apart. The EU Member States outside the euro area should be actively involved in the process of further deepening the Monetary Union. However, they should not have any veto rights over possible further steps towards integration.

In this way, innovation is promoted and jobs are created. Consequently, implementation of the social market economy secures the future too – especially for young people.

Compared to Japan and the United States the “euro area” is the only large economic area where debt in relation to gross domestic product has been successfully reduced.

Debt Ratio (Gross Debt) in % of GDP



The euro area needs a liberal, competitive and socially balanced European economic, financial and fiscal system. This means that national competencies are retained in accordance with the principle of subsidiarity and must also be experienced in reality. Therefore, better policy coordination is a must in present times.

Economic policy coordination to be strengthened

Boosting the competitiveness in all of the many regions of the euro area requires effective economic policy coordination. This serves to improve competitiveness, promote sustainable growth and reduce structural weaknesses in the Member States. The aim must be to strengthen the economically weaker Member States and not to weaken the stronger Member States.

Competition between economic politics

A decisive element for coordinating and linking national economic policies is the European Semester. The procedure must be transparent, streamlined and clear to ensure its efficiency.

To this end, the direct responsibility assumed by Member States should be reinforced and their action geared to the principle of best practices and recognised benchmark systems. It is logical to concentrate country-specific recommendations on key priority areas. The emphasis should be placed on structural reforms and budgetary consolidation. Moreover, strengthening the investment potential of municipalities and local communities must always be taken into consideration in order to create a solid foundation for growth.

Structural Funds should be used to implement the recommendations. The recommendations should not, however, include any detailed individual measures as this would unnecessarily restrict the sovereignty of Member States. Instead, what is needed is an early, intensive exchange between the European Commission and the Member States on the recommendations of the European Semester. Considerable progress has been made to this end in recent years.

For instance, the national parliaments are involved more systematically and more comprehensively in economic and budgetary policy coordination. In this way, individual responsibility and readiness to reform are strengthened in the Member States.

A further instrument for economic policy coordination is the procedure in case of a macroeconomic imbalance. This procedure should continue to be used. The focus should be on Member States with current account deficits. They must increase their competitiveness through reforms and in this way reduce their deficit. The procedure can also contribute to protecting the Monetary Union against the perilous formation of bubbles, as we experienced in the crisis, for example, on property markets.

The free movement of workers in the EU is a further starting point for promoting growth and prosperity. In order to further encourage worker mobility, the recognition of professional qualifications, for example, should be simplified. Existing, tried and tested training and qualification standards should, however, not be compromised.

Warning should be given against seeking influence at European level for national wage determination processes and interference in the autonomy of collective bargaining. This also includes the coordination of minimum wages in the Member States. This contradicts the principle of subsidiarity and therefore must be rejected. Moreover, the idea of a European unemployment insurance puts an excessive strain on solidarity in Europe and is detrimental to assuming direct responsibility of Member States.

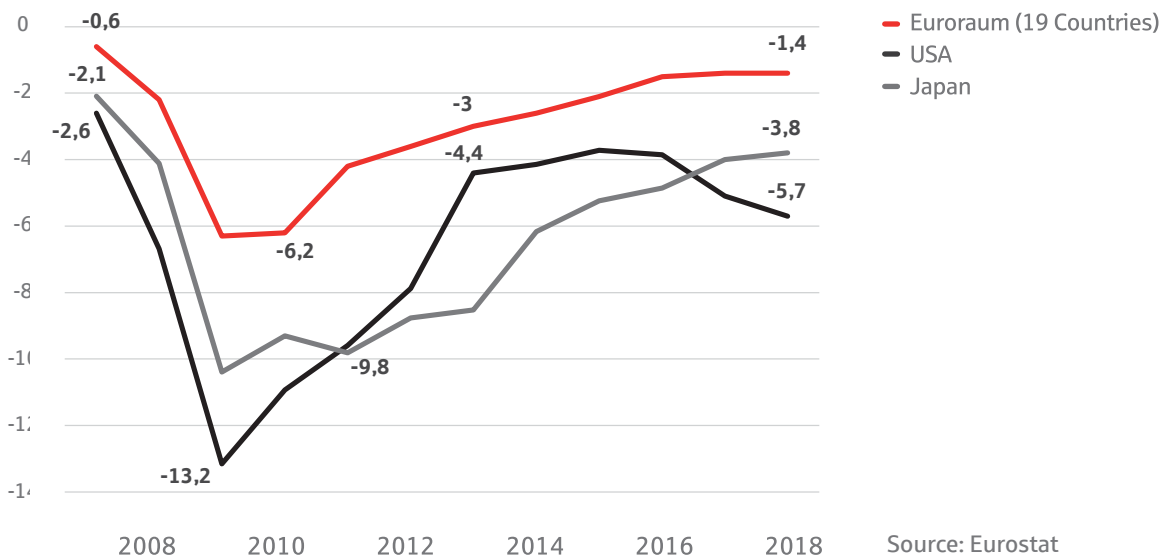
Redistribution within Europe - the wrong track

A common unemployment insurance scheme would lead to permanent transfer payments within the euro area and weakens incentives to reduce structural unemployment in particular. The national unemployment insurance schemes are structured differently and are embedded in the individual taxation and transfer systems and labour markets. As national economies and labour market policy conditions in the euro area vary greatly, joint unemployment insurance is not an option.

Binding and credible fiscal rules have to be implemented

Under the principle of subsidiarity, the Member States bear direct responsibility for a sound budgetary and financial policy. Sound government finances stand as a guarantee for a State being capable of taking action and a stable euro. In comparison to all other large economic areas, the “euro area” is the one most advanced in reducing public deficit.

Deficit Ratio in % of GDP



Source: Eurostat

Existing fiscal rules in the EU offer sufficient flexibility to absorb economic shocks. The Stability and Growth Pact is the central pillar of the euro area. The addition of the Fiscal Compact was a logical move. Compliance with

fiscal rules is essential in order to ensure a responsible fiscal policy in all Member States. In particular, debt ratios in the Member States should be reduced in a sustainable manner and risks for the entire Monetary Union avoided. The surveillance of fiscal policy of the Member States by European institutions should be in three stages:

As long as a Member State complies with the stability criteria, European institutions can give non-binding recommendations, but cannot impose any legally binding budgetary requirements.

If a Member State infringes the stability criteria, the European institutions must be able to impose binding requirements to limit the deficit or reduce the debt level. However, the decision continues to be left to the Member State as to how these requirements are to be implemented.

If a Member State infringes the stability criteria in such a way that emergency assistance from the European Stability Mechanism (ESM) becomes necessary, agreements on specific, binding requirements are advisable. If a Member State claims financial assistance, it must be prepared to accept restrictions to its budgetary autonomy and to accept requirements for structural reform involving the European Parliament. Here the principle of conditionality must take effect: solidarity can only exist if there is solidity and stability.

Strict stability criteria required

Implementation of existing rules must take precedence over the creation of new rules. For this purpose, the Vice-President of the European Commission responsible for the euro and financial stability could be given a similarly strong position for the review of the stability criteria as the Commissioner for Competition. In addition, the European Stability Mechanism (ESM) should be assigned stronger powers with a view to monitoring the financial and economic policy, especially of Member States claiming ESM financial aid. The European Parliament and the national parliaments must stringently exercise their parliamentary control rights in this respect.

The fiscal rules only take full effect if infringements of the stability criteria have consequences. Otherwise the Stability and Growth Pact will remain a paper tiger. To boost credibility of the Stability and Growth Pact and the fiscal rules, consideration should be given to restricting the discretion of the European institutions – and especially the European Commission – in the case of deficit procedures to give the Council the possibility of decision. If the conditions are met, sanctions should be strictly applied.

The European Stability Mechanism (ESM) has proved its worth as a crisis mechanism. In order to boost the credibility of the no bail-out clause, the ESM should also gradually be supplemented with a framework including clear time limits for Member States of the Monetary Union. Aides from the ESM

would thereby be linked to an obligation for debt restructuring, which must necessarily take place with the participation of private creditors and be associated to a macroeconomic adjustment programme. With a strong framework in the case of excessive debt situations, at the same time a strong incentive would be given to comply with the existing fiscal rules. Moreover, the ESM as a kind of “European Monetary Fund” and, together with the International Monetary Fund, would be a central pillar for stabilising a financial markets framework.

ESM as European Monetary Fund

The EU budget must be used primarily for measures which yield a European added value. On the revenue side, the efficiency of the own resources system should be increased. The EU resources must be more concentrated overall on European tasks for the future. The EU must pursue a budget policy with a sense of proportion.

European financial market framework - paying more attention to diversity

An effective separation of monetary and financial policy remains vital for a currency such as the euro. There may therefore be no direct monetary public sector financing. In addition, separation of monetary policy and banking supervision is important to avoid conflicts of interest. The political independence of the European Central Bank must be guaranteed also in the future. Only in this way an effective common monetary policy with the aim of monetary stability can be ensured.

The central pillars of a European financial market framework are a functioning Banking Union and an appropriate Capital Markets Union. A suitable format for the Banking Union requires mitigating the risks originating from banks for States and from States for banks. Taxpayers must be protected from liability for the recovery or resolution of insolvent banks. A European banking supervisory authority has already been created, a Single Resolution Mechanism has been realised and the national deposit guarantee schemes have been further harmonised to gradually achieve such a Banking Union.

Functioning banking union

With a view to the current situation of some important banks in the euro area, as well as the problem of non-performing loans in bank balance sheets, it is particularly important for the Banking Union to do whatever possible to apply rules strictly and resolutely. The ECB, in particular, should not be allowed to refinance non-performing loans. Otherwise, a dramatic loss of trust in the Banking Union will ensue.

The Bank Recovery and Resolution Directive and the Deposit Guarantee Scheme Directive must first be implemented in full in all Member States.

Further new discussions on a European deposit guarantee scheme would be counterproductive and contradictory to direct responsibility, as they put a considerable strain on confidence in the banking system.

In banking regulation, there should be differentiation between the different institutions. Due to their lower systemic importance and complexity, smaller banks and savings banks which do not operate internationally should be excluded from burdensome regulations, or at least included to a lesser extent ("Small and simple Banking Box").

As a result of the impending withdrawal of the United Kingdom from the EU, there is an opportunity for Frankfurt/Main to become the European financial trading centre in the EU. Every effort should be made to capitalise on the financial market expertise of Frankfurt and to establish the European Banking Supervisory Authority (EBA) in Frankfurt.

Appropriate Capital Markets Union

At the same time, the European Securities and Markets Authority (ESMA) in Paris could be strengthened. However, the way should not be paved for excessive consumer protection.

In summary, it remains particularly important that the right steps are taken towards completion of the Monetary Union in the coming years. To this end, it is essential that the next focal points for the acceleration of the integration process are chosen with great care.

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