Finanzgruppe
Deutscher Sparkassen-
und Giroverband

STANDPUNKTE
DER CHEFVOLKSWIRTE

Review of the EU and euro area economic policy framework: Linking stability and sustainability!

The European Commission launched an "Economic Governance Review" in early February 2020. For the Chief Economists of the institutes affiliated in the DSGV, it is essential to ensure long-term stability and to incorporate the experience gained over the more than 20 years since the introduction of the euro. The fiscal-policy situation is currently being completely shaken up by the coronavirus pandemic. The consolidation tasks after the pandemic will be all the more challenging. Once the acute phase has been overcome, however, the rules for fiscal policy must be fundamentally and methodically reset. For this reason, the Chief Economists are actively participating in the consultation, presenting their positions on the nine key questions brought up by the European Commission:

- **The improved framework for economic-policy coordination following the 2009/2010 financial and sovereign-debt crisis has proved its worth in the current Covid-19 pandemic. The rules have enabled flexible action at a national and pan-European level. This has helped to ensure that the first indications of recovery can now be detected after the slump in the euro area economy.**

- **The current economic-policy debate concerning whether the European regulatory framework should also be applied flexibly in 2021 and subsequent years, or whether the Maastricht criteria should be partially suspended, must be conducted with caution. In the current situation, the focus is on supporting recovery, but it would be wrong to completely ignore the fiscal consequences.**

- **The medium-term consequences of excessive public debt must be taken into account. We believe that the overall discussion should also include the design of the Reconstruction Fund for Europe and the final agreement on the Medium-Term Financial Framework (MFF). A decision on the future configuration of economic and fiscal-policy rules should not be taken until the end of the German Presidency.**

17th June 2020

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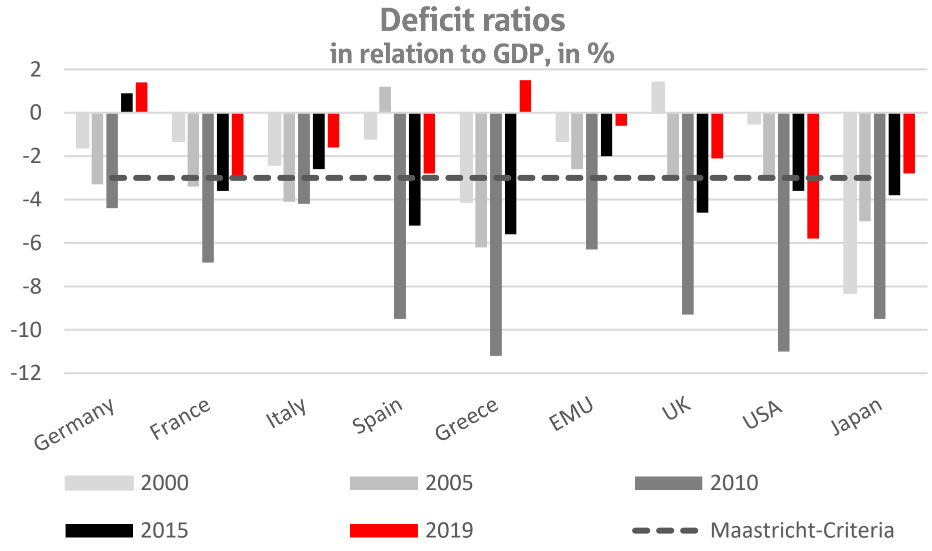
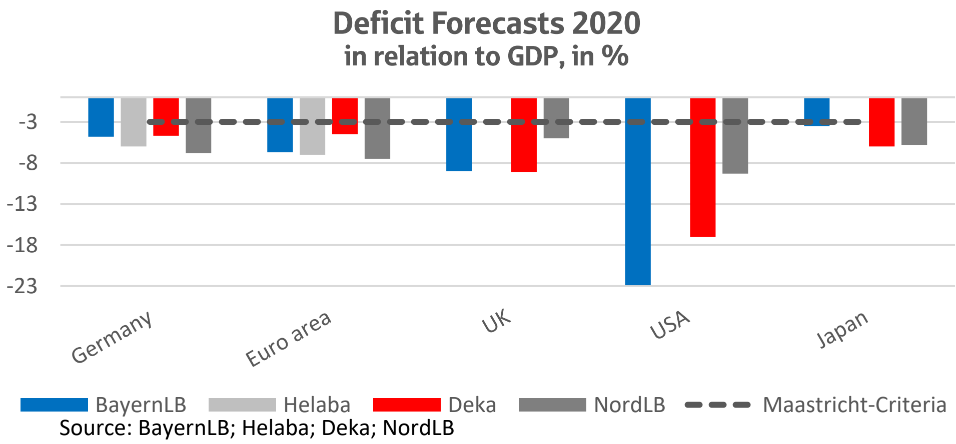
Starting point for the review

Covid-19 pandemic: high indebtedness will be the defining issue in the 20s

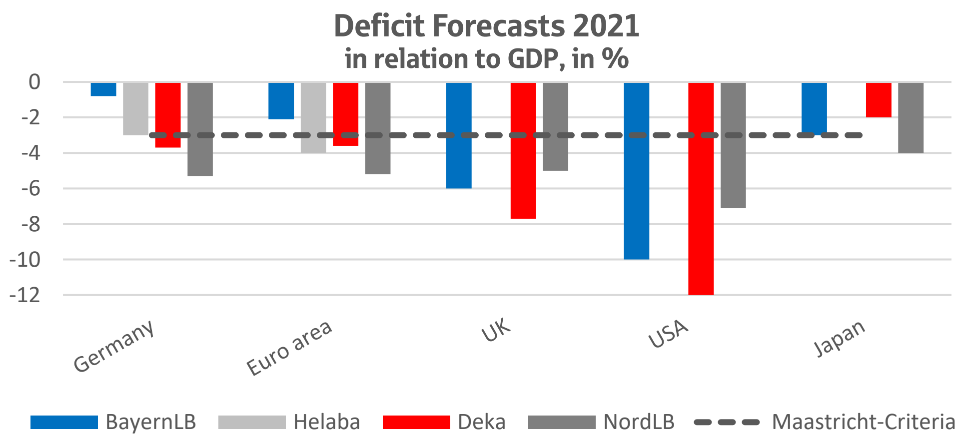
In its communication of 5 February 2020, the European Commission portrayed the development of economic-policy governance in Europe over the past decades. Although this consultation is now on hold, the issues raised will shape the economic-policy agenda for the coming decade. From the perspective of the Chief Economists of institutes affiliated in the DSGV, the developments must be assessed in a differentiated manner. All in all, it can be stated that up to 2019 the deficit ratios in the euro area fell relatively sharply, even on a global comparison.



Source: Eurostat; IMF



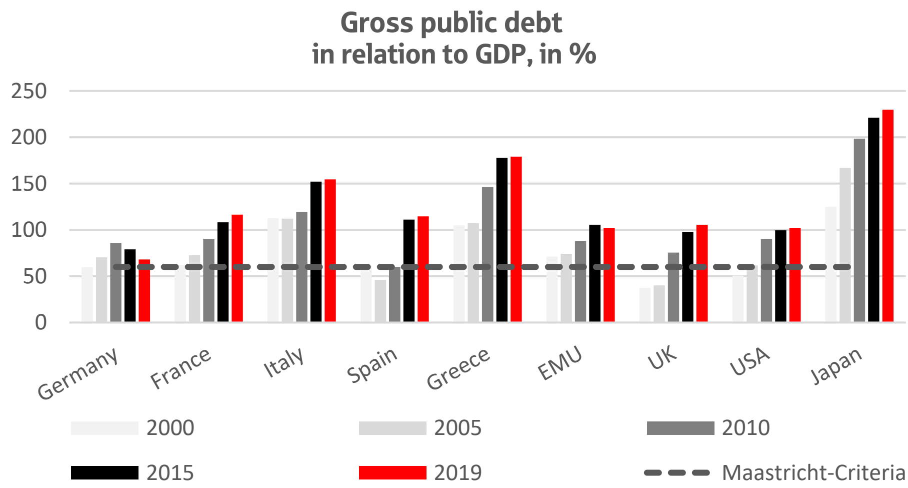
Source: BayernLB; Helaba; Deka; NordLB



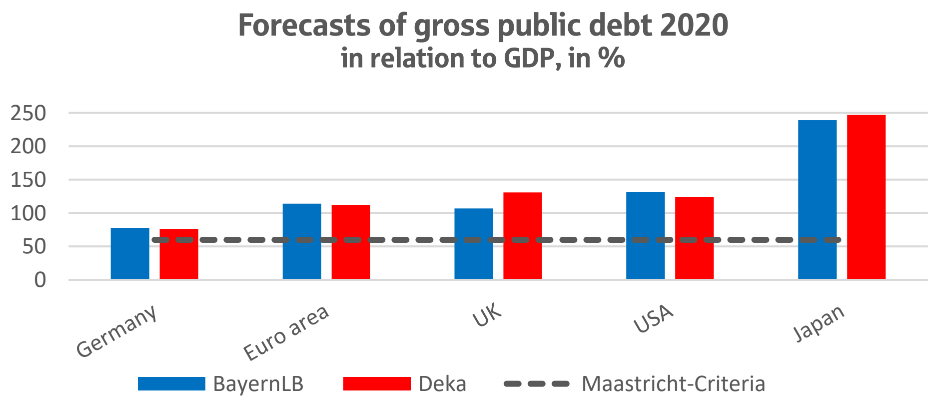
Source: BayernLB; Helaba; Deka; NordLB

In the aftermath of the coronavirus crisis, the institutions of the Sparkassen-Finanzgruppe estimate that the deficit ratios in the euro area will rise again and will be well above the 3% Maastricht deficit-ratio target. For 2020, this is in any case permissible under the exemptions of the current European framework and has accordingly also been justified by the European finance ministers and the heads of state and government in Europe in view of the exceptional "Corona pandemic" situation. By international standards, the increases in new debt in the euro area are still comparatively moderate. Especially in the US, new debt will rise significantly in 2020 and 2021, with deficit ratios of well over 10%. This will inevitably also have an impact on government debt ratios. To this must be added, in effect as a supplementary or shadow budget, the debt that is to be raised at the European level within the framework of the reconstruction fund.

A moderate trajectory was also evident on this score until 2019. The euro area as a whole was even able to reduce its government debt ratio in the period after 2015. This means that the euro area can certainly hold its own on an international comparison. Currency areas like the yen bloc, for example, with government debt of over 240%, have hardly any more options for action via monetary and fiscal policy, and in the other currency areas, like the US dollar bloc or the sterling bloc, government debt levels in relation to GDP have likewise reached levels that raise questions about the limits of government debt.



Source: Deka; IMF



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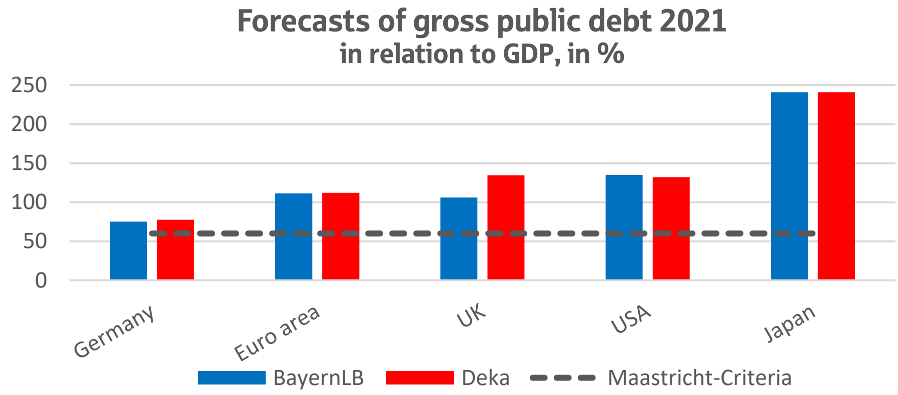
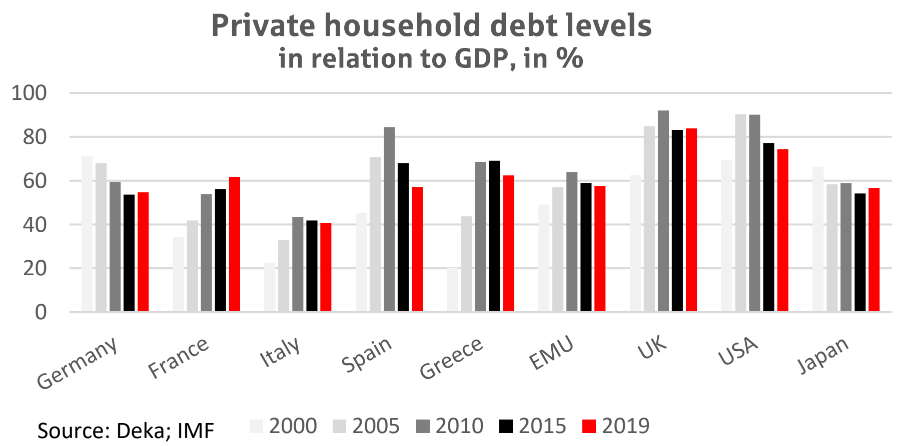


Source: BayernLB; Deka

That public debt is in danger of bumping up against limits will become even more apparent in view of the developments spawned by the Covid-19 pandemic worldwide. In the coming decade, the Chief Economists expect that over-indebtedness will be a decisive factor in discussions unfolding on the financial markets, in a global context as well, but also on the political front. In principle, the core of the existing regulatory framework should be retained, but certain parameters ought to be cautiously optimised.

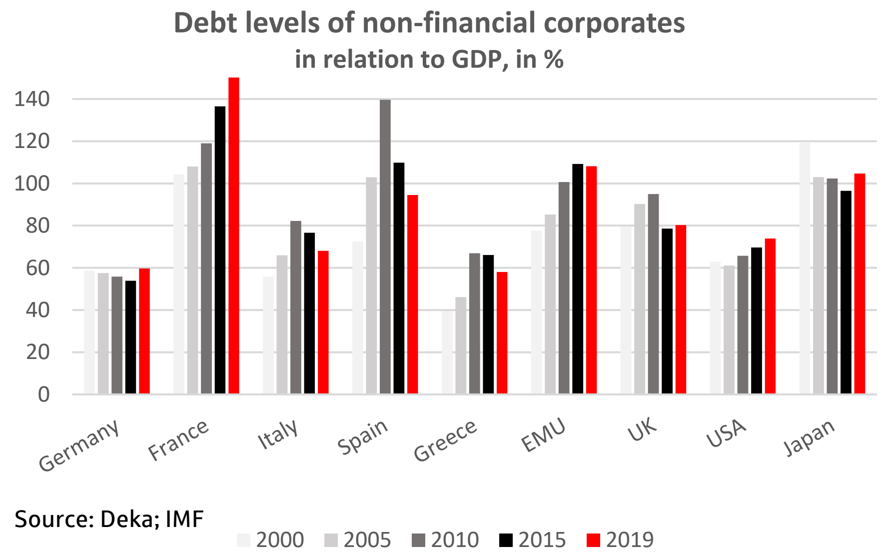
Economic governance will be even more strongly influenced by debt issues in the future

With regard to economic governance, the other decisive debt-ratio parameters - household debt and corporate debt - should also be taken into account on an international comparison. Overall, for example, the debt levels of private households have hardly been able to be reduced in a global context. The extent to which the coronavirus pandemic will lead to new debt burdens in this sphere will now become a question of considerable economic significance. In systems such as the European social market economy, household debt is unlikely to increase as much as in more market-oriented systems such as the USA, where the loss of household income due to rising unemployment would be more likely to be compensated for by new debt than in the case of Europe.



Source: Deka; IMF

What is more, a further increase in debt levels is also on the cards for non-financial companies in the wake of the Corona pandemic. Aggregate debt levels have also risen in this sector over the last two decades. In the Savings Bank Finance Group, lending to companies rose more sharply in the first quarter of 2020 than ever before in any quarter. The economically intriguing question will now be how the resulting new corporate debt levels will develop in relation to insolvency figures. Initial findings in this regard are not likely to be available until the second half of 2020 at the earliest.



The overall conclusion reached by the Chief Economists is that the new over-indebtedness arising worldwide in the wake of the Covid-19 crisis will prove a crucial preoccupation for economic and fiscal policymakers over the next decade. As a consequence, Europe should switch back to a sustainable consolidation course as soon as possible. Now is not yet the time to decide on a further exception to the rules, but at the end of the German Presidency it should already be more obvious whether a revival of economic activity in the euro area, and in Europe in general, makes a more complete return to the rules possible.

Budgetary rules/structural reforms are more important than trade imbalances

In future, European budgetary rules and structural reforms must be at the heart of economic governance. These are the two cornerstones that will shape Europe's competitiveness going forward. Less important in this context is the evaluation of trade imbalances. These are often the outcome of market processes and cannot be artificially manipulated. To that extent, they can hardly be controlled by economic-policy means either.

As a result, the questions about the scope and limits of economic-policy management will be answered against this backdrop. The European Commission has drawn up nine key questions, in connection with which the Chief Economists would like to provide the following proposals:

1. How can the framework be improved to ensure sustainable public finances in all Member States and to help eliminate existing macroeconomic imbalances and prevent fresh ones from arising?

It is true that the rules governing the Stability and Growth Pact have helped to achieve consolidation targets in some euro area countries. In many member countries, however, the Stability and Growth Pact has proved unable to fulfil its debt-reducing function. In such cases, deficits remained too high or growth too low to reduce debt levels, which had swollen after the financial crisis, as a proportion of the gross domestic product. The recent sharp surge in deficits to mitigate coronavirus-induced demand shortfalls will once again push up the debt levels of European countries significantly. Some countries are thus reaching debt levels at which, in the event of further adverse economic developments, the confidence of capital markets may be lost, thereby threatening a serious sustainability crisis.

Plea for a "mixed policy" to cope with high debt levels

Once the acute phase of the Covid-19 pandemic is over, a make-or-break decision must therefore be taken: Either work will continue on reducing the debt level in relation to the gross domestic product, or permanently excessive debt levels will be accepted, with the independence of monetary policy from fiscal policy thus being definitively abandoned. We advocate a "mixed policy" graduated over time. In the first half of the 20s, debt levels well in excess of the previously agreed level must be tolerated. However, a roadmap should be defined for each country to determine how debt levels can be brought down again individually. This should be contractually agreed between the countries. Such a compact should also include redistributive elements, for example in the context of the European Reconstruction Fund to be set up after the coronavirus crisis. Further substantial structural and budgetary aid should be made available from a permanently increased EU budget provided that the Member States, together with the Commission, agree on appropriate economic-policy reform measures at the same time.

Simplification of the extended Stability and Growth Pact

The aim should be to simplify the extended Stability and Growth Pact, moving away from macroeconomic fine-tuning. Structurally weak regions should receive support from a pan-European programme for the establishment of production structures in connection with the re-regionalisation of value chains. Instead of macroeconomic fine-tuning, the European Union should also use its considerable market power and trading weight in the world to ensure that the multilateral approach to world trade is maintained as far as possible. That would be an enrichment of economic governance for Europe.

2. How to ensure responsible fiscal policies that safeguard long-term sustainability, while allowing for short-term stabilisation?

States must always be liquid and solvent. In the normal case, liquidity is provided by the market, and more recently, if necessary, by the ECB. Solvency is the difference between the interest payable on debt and GDP growth, the measure of a country's tax base. If growth is higher than the interest rate, fiscal leeway opens up. Such leeway can be used for short-term economic stabilisation. We currently see this in the consequences of the Corona pandemic, where the fiscal response is easier to mount for those states that have used the past years to consolidate their public finances and have complied with the fiscal ceilings prescribed by the Maastricht Treaty.

Sustainability: No new exemptions ...

... but consider digitalisation and demographic change as a challenge!

In the long term, most EU countries face similar challenges: The ageing population will cause GDP growth to shrink. From a fiscal-policy perspective, it is true, this burden will be lightened by the fact that real interest rates are also on a downward trend (which, in turn, puts a strain on funded pension and health-care systems). However, the EU Commission's long-term projections (e.g. Ageing Report 2018) suggest that the costs associated with ageing (pensions and care) will considerably curtail the room for manoeuvre available to national budgets, and in some cases may even overburden them. Long-term sustainability prospects can be improved by a targeted investment policy focused on sustainable assets. Above all, these involve investments in keeping with a digital agenda. The development of an appropriate infrastructure and the promotion of science and education promises high and lasting returns. Green investments can also be sustainable in this sense, provided they reduce the damage expected to be wrought by climate change. In both cases, however, the following principle should apply: As much government as necessary, as much market as possible. It should not be the task of fiscal policy to permanently crowd out the private sector.

3. What is the appropriate role for the EU surveillance framework in incentivising Member States to undertake key reforms and investments needed to help tackle today’s and tomorrow’s economic, social, and environmental challenges while preserving safeguards against risks to debt sustainability?

Despite the multiple revisions of the EU monitoring framework ("Six Pack", 2011 and "Two Pack", 2013), weaknesses can still be identified. The persistently high (gross) debt ratios in several Member States must be seen particularly critically against the background of simultaneous shortcomings in the field of public finances, especially with regard to public investment (inter alia in climate protection and digital infrastructure). However, even some Member States with - at least in 2019 - uncritical deficit and debt ratios have recently been increasingly criticised for the quality of public spending, especially for a level of public investment that is considered too low.[1]

Macroeconomic investment capability, which still needs to be significantly strengthened, is also partly responsible for Germany's high savings surplus and the resulting current account surplus. To this extent, there are certain goal conflicts between reducing imbalances and meeting budgetary targets. The solution can only lie in a qualitative improvement in government spending that contributes to both goals.

[1] An example is Germany, which had recorded several years of negative net public investment and a corresponding reduction in the public capital stock. Prior to the Covid-19 crisis, national demands for higher investments were voiced by the DGB and BDI (with the participation of the respective affiliated economic research institutes IW and IMK), while at the same time the EU Commission recommended Germany to use existing budgetary leeway to boost public investment.

Fiscal solidity should remain the guiding principle after the pandemic

The identified weaknesses in fiscal surveillance need to be reduced in order to achieve the main objective of the surveillance framework, namely to ensure the long-term sustainability of Member States' public finances. Adherence to quantitative targets/limits is crucial for this, but so is a higher quality of public expenditure.

However, an excessively detailed fiscal surveillance framework is not suitable for fine-tuning fiscal policy under national budgetary sovereignty, since it can only set limits for the Member States that are as universal / generally applicable as possible or monitor compliance with them. It remains crucial that there is a living commitment to the objective of consolidating public finances in normal, favourable economic times as well. New expenditure rules, to say nothing of new supervisory institutions, therefore do not help. We view these critically. Policymakers should therefore refrain from setting overly detailed guidelines, especially since politically desired goals cannot be achieved through public investment/expenditure alone (regulatory framework, mobilisation of private investment, etc.).

Policy recommendations to Member States on how to address economic, social and environmental challenges in a concrete way could be taken into account in the framework of the Country-Specific Recommendations. Initially, the degree of implementation of the country-specific recommendations was low because the proposals were too detailed and rarely addressed the major reforms in the Member States. In the meantime, the procedure has improved significantly during the European Semester and important macroeconomic issues such as digitisation, sustainability or inequalities are being addressed on a country-specific basis. However, there is still a need for better comparability when comparing the recommendations for the various countries. This should therefore be enhanced even further, as the Bundesbank has already demanded.

Nevertheless, fiscal rules - if properly designed - can provide incentives that work both to improve public expenditure in terms of higher or more sustained public investment activity and to ensure medium-term fiscal sustainability.

- **Rainy-Day funds:**
  So-called national Rainy-Day funds could reduce the risk that Member States would have to consolidate procyclically in the event of unexpected structural slumps, which often affect investment disproportionately. This would also provide more leeway within the fiscal rules for an active stabilisation policy. The funds would first be "saved up" (in a notional account) by exceeding the medium-term budget target (MTO). However, the risk of "political business cycles" would have to be obviated when framing the design. To this end, technocratic surveillance that is as depoliticised as possible would be advisable.
- **Golden Rule:**
  Debt options for public investment via a so-called Golden Rule entail some risks, but these could be contained. A tight, symmetrical and capped Golden Rule would address a large number of failures from the past. For example, the investment definition would have to be narrow (e.g. national

accounts definition). Only for positive net investment - up to an upper limit (capping) - would an additional debt option be allowed and the rule would have to be symmetrical, i.e. negative net investment would result in more ambitious budget targets.

4. How can one simplify the EU framework and improve the transparency of its implementation?

The combination of structural measures designed to have medium-term effects with budgetary surveillance is detrimental to the binding force and clarity of fiscal targets. In order to strengthen intelligibility and transparency, it is advisable to reduce the complexity of the recommendations for action as a matter of priority. The focus should be on sufficiently established fiscal-policy indicators. New rules such as spending rules raise far-reaching new questions of interpretation and should therefore not be adopted (see also the Statement by the Chief Economists published in February 2018).

No new set of rules is required...

Taking one's bearings by the structural budget balance remains correct in substance, but also leaves room for interpretation, in particular when adjusted for cyclical influences.

A comparison of the figures for the current budget balance with the corresponding figures for the structural balance, and a comparison of the difference between the two figures regarding the gap expected in the current year and the one reported two years later, shows that there are considerable disparities between the individual countries. In France, for example, an average temporary burden on the budget situation of 1.3 GDP points has been estimated for the period 2013 to 2017, which then shrank to 0.8 GDP points afterwards. Supplementary indicators based on the historical deviation between originally projected and later realised values could illustrate such dangers and help to classify their country-specific magnitude.

...but mediation problems need to be solved!

The temporary suspension of all deficit procedures initiated after the financial crisis points to a mediation problem in view of the unsatisfactory development of the debt situation noted above. Fiscal surveillance, which, conceptually, is strongly geared towards a reduction of the general government debt burden, needs to be tightened, especially with regard to this factor. Debt developments should be focused on as a yardstick that sets the framework for other fiscal targets. Again, a comparison of actual developments with previously projected developments could provide additional information for the assessment of current budgetary plans.

5. How can surveillance focus on the Member States with more pressing policy challenges and ensure quality dialogue and genuine commitment?

All medium-term economic and employment-policy coordination and monitoring processes are currently subsumed under the term "European Semester" in a uniform procedural framework. Pursuant to this, it is the task of the European Commission, as the coordinating institution, to combine the positions of the various national stakeholders, some of whom are influenced by different economic-policy paradigms, in such a way as to enable effective overall action.

In addition to the general scientific and political environment, the views and interests of the individual macroeconomic actors are important for identifying the need for reform. Since the need for reform is often due to very different causal complexes in different countries, an expansion of the dialogue should be advocated not only between the political leaders of the individual governments, but also with the key stakeholders of the national economies. Furthermore, it should be considered whether it would be useful to institutionalise the stakeholder dialogue in the form of a firmly established independent advisory body at both the national and the pan-EU level. In any case, an important step in the macroeconomic dialogue organised by the European Commission would be to involve not only the social partners but also the European banking industry.

European Semester: Broad-based involvement of society at large

In order to counteract undue consideration of interest groups and ideological positions, benchmarking and indicators to identify best practices are a good means of shaping change. The advantage of these soft forms of coordination is that they allow competition and the discovery of best practices and do not unduly restrict national room for manoeuvre. To this end, the European Commission should develop uniform questions tailored to the individual areas and/or have them assessed by the EBA and the ECB. With regard to banking and financial markets, questions relating to the stability of the financial system could, for example, focus on the evaluation of non-performing loans, on the lending conditions to be imposed or on the assessment of whether a banking market is "overbanked" and "overbranched". Within the framework of a dialogue, country-specific conditions and institutional constellations could then be taken into account by naming one's own contribution and expectations regarding the contribution of the other actor towards achieving a given goal.

Financial markets: A level playing field is important

If the contribution made and the contribution expected to be made towards achieving a given objective differs, non-binding recommendations for measures to be taken by the Commission and the Council to the Member States are desirable. However, in order to take account of country-specific circumstances, the corrective action plans should be drawn up by the Member States themselves. Early discussion of the plans would be conducive to defusing potential conflicts from the outset and could strengthen the prophylactic character of the dialogue. At the same time, the planning security of the actors involved would be increased.

6. How can the framework ensure effective enforcement? What should be the role of pecuniary sanctions, reputational costs and positive incentives?

Ideally, the framework should be set in such a way that it enables the market to give governments incentives to put their budgets on a sound footing through the pricing of government bonds. However, this market mechanism is being clearly impeded by the ECB's ever-increasing influence as a result of an ultra-lax monetary policy. As the latest assessments of the rating agencies document, the debt sustainability of the European states with weaker credit ratings is largely dependent on favourable financing conditions. This suggests that the ECB is not likely to end its support abruptly. The implication is that market mechanisms will not be able to work to the full in the future either. Accordingly, the institutional framework must be designed in such a way that the achievement of the targets becomes more important even if the corrective market mechanisms have a limited effect. At the same time, the aim should be to improve the creditworthiness of the weakest Member States as quickly as possible. This would allow the ECB to reduce its involvement and the supportive effect of market mechanisms could be reinstated.

The history of the European Monetary Union has shown that sanctions for breaches of budgetary rules are difficult to enforce. This is partly due to the fact that such breaches do not only affect individual states, but often a group of states. As a result, coalitions often form, making it considerably more difficult for sanctions to be enforced against the respective members of the group. In order to rectify this problem, the monitoring of the rules, the detection of violations and the formulation of sanctions should be carried out by an independent institution. At the same time, the hurdles for overruling these recommendations should be set high.

Fines not working...

With regard to the nature of the sanctions, imposing punitive payments on states that already have a poor credit rating appears to be of only limited use, as such fines initially counteract the desired objective of a sound budgetary position. With the loss of the market corrective, this instrument has, furthermore, been seriously blunted. If the market mechanism were fully effective, a penalty payment would lead to an additional increase in risk premiums at an early stage for states starting with a decent credit rating, thus forcing the state to take countermeasures. In the case of countries with already poor credit ratings, however, this could lead to a massive increase in financing costs, which could jeopardise the debt sustainability of the countries concerned. As an alternative to fines, a framework should therefore be created in which EU budget allocations are reduced at an early stage in the event of impending infringements of the rules, or voting rights could be withdrawn in certain policy areas for the duration of the infringement.

... support systems are better

In order to confer incentives, particularly on those countries that are far away from meeting the targets (e.g. countries with high debt ratios), to comply with the rules, a support system would be desirable. Convergence towards the respective target value could trigger access to additional European funding (as a transfer) for future-oriented investments (e.g. in the domains of digitisation or climate protection). This could also be implemented by increasing the EU share in jointly financed projects. Alternatively, the EIB or the ESM could provide concessionary loans for "well-behaved" states. The financing benefits would be based on the progress being made towards achieving the targets. This would make it possible to improve locational conditions and thus lay the foundation for higher growth potential and, accordingly, a broader medium-term tax base. The effects of such a reward system would even be enhanced if the market corrective were fully restored.

7. Is there scope to strengthen national fiscal frameworks and improve their interaction with the EU fiscal framework?

The Stability and Growth Pact and the Fiscal Pact provide a detailed and sophisticated set of rules designed to prevent chronic budget deficits and ballooning public debt. However, since these rules have often been neglected in the real political-institutional world, readjustments are necessary. The answer to the previous question already indicated that independent institutions would be a promising approach here. Such a role could be performed by so-called "fiscal councils".

Strengthen fiscal councils!

Fiscal councils are independent institutions that perform a supervisory, exhortary and advisory function and, in particular, monitor compliance with the established deficit rules with the ultimate aim of ensuring sound fiscal policies. At the European level, the establishment of an independent European Fiscal Board (EFB) was decided in 2015. It is the task of the EFB to evaluate the coherent interpretation of fiscal rules in the euro area, take a position on the alignment of fiscal policy in the euro area and cooperate with the national fiscal councils.

Similar models exist at national level: In Germany, compliance with the ceiling for the structural general government deficit has been monitored by a stability council since 2014. This council consists of the Federal Minister of Finance, the Federal Minister of Economics and the Finance Ministers of the federal states and is supported by its own independent Advisory Council. However, both the EFB and the German Stability Council have mainly advisory functions. It would need to be clarified to what extent the binding nature of the exhortations and recommendations could be reinforced.

In democracies, budgetary law is the "royal right of parliament". The members of the national parliaments are responsible to the voters in the respective member states. At the European level, such a right for Brussels to levy taxes of its own does not yet exist. In order not to foster ruinous competition between the tax systems of the Member States during the further course of European integration, efforts have therefore been made in recent years to standardise the tax bases for various taxes. Here, the efforts on the part of EcoFin and the Eurogroup must certainly continue and joint answers must be found to tax issues in order to shape the future viability of Europe.

8. How should the framework take into consideration the euro area dimension and the agenda aimed at deepening the Economic and Monetary Union?

A decisive factor in anchoring stability mechanisms at a pan-European level is compliance with the basic principles of a social market economy. As a matter of principle, self-responsible organisations of individuals and companies as well as banks and savings banks should always be given priority over state responsibility at the various levels of government. In this respect, the principle of subsidiarity remains decisive for a Europe of unity in diversity.

Unity in diversity

In the euro area, success stories have already been written on this score. European governance has been strengthened in many areas in unison with national and regional responsibilities. Over the years, the European Commission has been increasingly successful in ensuring that the countries of Europe and the euro area are assessed by the same standards, even though challenges remain.

In recent years, the macroprudential dimension for deepening the European Monetary Union has gained in importance. This is rightly being made a national responsibility and coordinated at a pan-European level. The coronavirus pandemic in particular has shown that, on the basis of the ECB's request, as part of its mandate in the European Systemic Risk Board (ESRB), national supervisors very quickly set the countercyclical capital buffer built up in previous years to zero in all countries as soon as the epidemic broke out. In addition, further regulatory relief was anchored via the EBA and the ECB, which has helped to ensure that the effects of the Covid-19 pandemic on the real economy have not yet spread to the financial sector. This interaction at the beginning of the current crisis should continue on a permanent basis after the crisis has ended.

Pay more attention to macroprudential aspects

The ECB has also contributed to the improved economic governance in the euro area. In the current Covid-19 crisis, the euro area's central bank has made its contribution by expanding its purchasing programmes and easing collateral requirements, so that the member states and European policymakers were able to resolutely counter the crisis with comprehensive fiscal-policy measures. It is important that a first extensive rescue package has been put together involving the EIB, ESM and "Sure". And the new Reconstruction Fund for Europe also points in the right direction on the basis of a comprehensive new guarantee system in Europe: solidarity for Europe without full communitarisation and thus preservation of individual responsibility. These are all important reforms for Europe. In any case, they are more important than eye-catching but simplistic discussions about a European Finance Minister etc., which would not move Europe forward in its current constitution.

Banking Union: much progress has already been achieved...

At the end of the day, the positive developments which have been made must also be contrasted with critical aspects. This applies in particular to projects which run counter to the heterogeneity and regionalism underlying banking market structures and which are not necessary for a level playing field in banking and capital markets. In 2014, for example, European legislators undertook a very far-reaching harmonisation of deposit protection rules, thus ensuring that every euro of deposits is protected according to the same standards throughout the euro area. Nevertheless, new and more far-reaching compensation mechanisms were discussed as early as 2015 – without the original national implementation timeframe even having been completed - and formally adopted by the EU Commission as legislative proposals which are essentially not conducive to achieving the desired objectives in terms of individual responsibility and stability. Instead of effectively abolishing functioning institutional protection systems as a result of centralisation and communitarisation, the EU Commission should regard institutional protection systems for regionally oriented credit institutions and their network structures more as a gain for stability and diversity in Europe. In any case, important far-reaching measures of liability-sharing still have to be agreed upon - measures which could create progress regarding the functionality of banking markets. This also involves finding common ways to deal with the state-bank loop. This remains crucial for bank resolutions on a European scale and is of elementary importance for counteracting size-related incentive distortions. Instead of putting new ideas for centralisation and communitarisation up for discussion, it is important

... no central deposit insurance system

to make effective use of the possibilities offered by existing institutions and support facilities.

In the Covid-19 crisis it has become more than clear that the established European Stability Mechanism (ESM) can help quickly and effectively. To this extent, the envisaged revisions should now be completed in a timely manner with the plans on hand. Before the outbreak of the Corona crisis, the ESM and the European Commission had seen to it, in accordance with macroeconomic guidelines, that many member states had emerged in favourable economic shape from their crises. This path should be pursued further, without further centralisation and compensation mechanisms on the deposit-insurance front.

Overcoming negative/low interest rates

Another problem confronting Europe's surveillance framework remains the negative, or else extremely low, interest rates in the euro area. In the current Covid-19 crisis, the ECB has so far rightly not used the interest-rate instrument. Further cuts in key rates would have tended to aggravate critical developments rather than to calm the financial markets. It therefore remains crucial to find an exit from the ultra-expansionary interest rate policy by means of accommodative fiscal-policy measures and the economic growth, accompanied by rising prices, resulting from this. After all, in a functioning social market economy, the price of money or credit - the interest rate - should once again perform better in its function as a measure of scarcity and a store of value.

9. *Within the context of the European Semester, how can the SGP and the MIP interact and work better together, so as to improve economic-policy coordination among Member States?*

As a conclusion of the analysis, and with reference to economic governance, which must again be comprehensively appraised under this rubric, the following steps enabling better coordination of the individual measures and their greater effectiveness should be considered:

- **Focus on already existing agreements:** Ensure a more stringent implementation of the respective national stability and convergence programmes. These could include an obligation to create national budget buffers in times of favourable economic activity in order for there to be leeway to act in a downturn - and to preserve national fiscal sovereignty and relieve the burden on monetary policy.
- **Check to see if systemic change is called for:** The manifestly inexpedient current sanction system should be replaced and a potential transition to a bonus system should be examined. States that better meet the agreed targets could then receive additional EU funds.
- **Streamlining of procedures:** The various analyses and reports as well as procedural stages should be streamlined so that recommendation - deadline - evaluation - consequence follow each other quickly and predictably. Set up automated processes wherever possible.

- **Best possible *organisational* dovetailing:** analyses, reports and evaluations preferably from a single source, short work paths, coordinated recommendations and controls.
- **Concrete definition of exceptions:** As the current “black swan” pandemic demonstrates so eloquently, events can occur which, being an exceptional situation, go beyond the scope of the agreed regulations. However, exceptions and scope for interpretation should be strictly limited in advance in order for there to be clear guidelines for action. Art. 122 TFEU, for example, which refers to "exceptional occurrences", leaves considerable scope for interpretation. A decision by governments on the basis of defined criteria as to whether a special situation exists could provide a basis here.

Disclaimer

The present position paper of the Chief Economists does not necessarily correspond to the attitude of the DekaBank or the attitude of the respective Landesbanken and Savings Banks or the DSGV.

Imprint

Published by

Deutscher Sparkassen- und Giroverband
Abteilung Volkswirtschaft, Finanzmärkte und Wirtschaftspolitik
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Editorial Deadline:
16th June 2020

Layout
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Photography
Pixabay/Rai 79

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Remark
You can access this document at
https://www.dsgv.de/positionen.html#standpunkte

ISSN
2509-3851