Finalising the Banking Union and Eurozone Governance

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In this paper, the authors analyse the state of play with reference to Meseberg's Franco-German "consensus" and then discuss the stakes involved with reforming the governance and the economic policies that are supposed to be conducive to financial resilience and the stability of the eurozone.

FEPS
BRIEF
October
2018

Fondation Jean Jaurès

FOUNDATION FOR EUROPEAN PROGRESSIVE STUDIES
FONDATION EUROPÉENNE D'ÉTUDES PROGRESSISTES

Communication around the European Council of 28 June on the European Union's migration policy – which confirmed a very disappointing compromise which is already unravelling – succeeded in masking what was another setback for the Council and President Emmanuel Macron: the inability to finalise the banking union and the rejection of the Franco-German proposal for the creation of a budget for the eurozone. This was despite President Macron having previously scaled back his ambitions to reach common ground with his German counterpart at the previous European Council in Meseberg.

Eurozone governance, an obscure subject due to its technical nature, is crucial to the future of the European Union and the fate of European citizens. 10 years ago the financial crisis shook our continent: the promise of a convergence of living standards in European countries wasn't fulfilled, inequality and insecurity in member states have risen, and added value is concentrated in the centre and the north, to the detriment of the peripheries. The coordination of economic policies has failed to prevent the accumulation of extravagant external surpluses by certain countries. International institutions are warning of the risks of another financial crisis and voters contesting the advice of economic policies from Brussels. The consequences of the financial crisis – both direct and indirect – remain visible today, while the continent's economic and monetary union is still largely incomplete. Eurozone heads of state could only take note of the disagreements between their finance ministers at their summit on 29 June. The extent of disagreement was not dissimilar to that seen the day before when discussing migration policy.

This article is split into two parts. In the first, we analyse the state of play with reference to Meseberg's Franco-German "consensus" – an already minimalist proposition compared to the ambitions President Macron expressed in his speech at the Sorbonne. This proposition hinted at the creation of a eurozone Finance Ministry, invested with major powers and subject to parliamentary control[1]. According to the Meseberg declaration, the objective is to make the eurozone more resilient by finalising the banking union and diversifying "European" instruments of financial and budgetary intervention. The second part deals with the stakes involved with governance and deciding on economic policies that are obscured when focussing the discussion on the objective of creating financial resilience and stabilising the eurozone.

1. From Meseberg to nowhere

"From Meseberg to nowhere": this was the title given by the well-known German financial newspaper Frankfurter Allgemeine Zeitung's to its 2 July editorial analysing the outcome of the eurozone heads of state meeting. Indeed, the post-council press release passed the buck, for the most part, to the finance ministers, whose disagreements were made explicit in a letter from their president, Portuguese finance minister Mário Centeno. In Meseberg, the Franco-German engine was running on empty.

[1] As it stands, many of the proposition's points warrant an in-depth critical discussion, but it had the merit of bringing together various budgetary instruments that, at this stage, deal with different approaches.

The Banking Union

The 2007/2008 global crisis, which reached its European climax in the summer of 2012, revealed the urgent need for a banking union. To prevent the banking crisis turning into a sovereign debt crisis, and stop the contagion that was threatening the eurozone, the European Council of June 2012 decided to move towards creating a banking union. This meant Europeanising banking supervision, mechanisms to deal with a bank failure and financial safety nets. Then, European Central Bank President Mario Draghi's famous July 2012 declaration of "whatever it takes"[2] calmed speculation and brought about a fall in interest rates. Nevertheless, the job of stabilising the eurozone cannot, without a banking union, rest solely on the shoulders of the ECB.

A system to supervise banks (first pillar) and resolve bank failures (second pillar) is already in place at a European Union level. It applies uniform rules to the eurozone's "big" banks that, given their size, would pose a "systemic" threat to the eurozone if they were to fail. Since 2016, every eurozone country has participated. The ECB plays the role of supervisor and has the power to initiate proceedings should a bank fail or be on the verge of doing so. A European agency, the Single Resolution Board (SRB), is in charge of ensuring the orderly resolution of failing banks.

The Single Resolution Mechanism (SRM) aims to minimise the need for public funding, preferring to use shareholders, subordinate creditors and other banking actors to preserve the bank's activities and functions that are critical to the economy and protect privileged creditors. The existence of a Single Resolution Fund (SRF), financed by banks provides a financial arm to the SRB that is particularly necessary to preserve profitable activities during a resolution. The question of available funds during a crisis is one of paramount importance. The SRF is set at 1% of the eurozone's projected 2022 total savings deposits. Countries collect the funds each year from the banks. Collection should be complete by 2023 and amount to approximately €70 billion. It currently stands at around €20 billion. Transitional arrangements, that foresee the use of first national resources and, only as a last resort, European funds through the European Stability Mechanism (ESM), have already been put in place.

Two important steps from the Meseberg declaration remain before the creation of a "banking union". Both deal with the sharing of risks. Two instruments are being discussed. The first would allow for risk sharing through a line of credit – a last resort "common backstop" – opened by the ESM (or its successor) for the SRF to use if ever its available funds were insufficient. The second instrument would be a "European Deposit Insurance Scheme", already described as the third and final pillar of a banking union when the idea was conceived. The EDIS would allow for the protection of depositors, within the limits of European law, and would be funded by contributions from banks. While the rules for protecting depositors are harmonised through a European directive, the insurance funds remain national. Their mutualisation would allow for better protection against larger crises and would protect depositors, which would reduce the risk of them making massive, destabilising withdrawals during a crisis.

[2] https://www.youtube.com/watch?v=tB2CM2ngpQg or https://www.youtube.com/watch?v=hMBI50FXDps

Heads of state have agreed to the first instrument, which will be put in place before 2024 (if conditions are met – a review is scheduled for 2020). They have also agreed that finance ministers should continue to discuss the second instrument, delaying the outline of a reform whose principle was broadly confirmed from the beginning of the banking union. The reality is that there remains fundamental disagreement between finance ministers on the link between sharing risks and their reduction. Germany, the Netherlands and other northern European countries oppose such a sharing of risks before the risks themselves have been addressed and significantly reduced. However, this reduction has, in large part, already begun. Germany and the Netherlands point, in particular, to the persistently high level of bad debts within the balance sheets of certain countries and want to link any future risk sharing to the effective reduction of such risks. They also demand the adoption of legal measures to entrench such efforts, notably by imposing a maximum rate for bad debts and harmonising legislation relating to failures. This approach, which has prevailed, is, for obvious reasons, not only contested by southern European countries, but also by the ECB itself (Frankfurter Allgemeine Zeitung, 30 June). They consider the reduction of risks to have progressed sufficiently and that, in fact, the sharing of risks would lead to a spike in confidence and would help to accelerate the resorption of these bad debts.

While we have been waiting for years for a precise road map for the finalising of the banking union, Meseberg only confirmed a sober compromise that had already been agreed by finance ministers and succeeds only in postponing, to a much later date, the sharing of risks. This compromise could be called into question by the new Italian government, due to conditions attached to the progress of risk sharing. The French agenda, already diluted by the Franco-German agreement, failed the test of June's European Council.

The outcome of discussions on the monetary and economic union of the eurozone is even more negative.

The reform of the European Stability Mechanism (ESM)

The European Stability Mechanism is Eurogroup's financial branch for when a country is faced with a public debt crisis. This mechanism does not fall within EU law and is enshrined in an international treaty. It functions in a strictly intergovernmental way and decisions made are not subject to debate at a European level. Its incorporation into Europe's treaty is envisaged, but ministers seem to not want to run the risk of bogging down "technical" reforms by linking them to an institutional reform that would open up a debate on the EU's treaties. Therefore, with regards to the reform of the European Stability Mechanism, Meseberg's Franco-German declaration is very closely aligned to the German position that swapping Wolfgang Schäuble for Olaf Sholz as finance minister failed to provide sufficient progress.

Aside from the creation of the last resort line of credit for the SRF mentioned above, it seems that a broad agreement was reached between the finance ministers to facilitate the efficient use of financial supports by extending the eligibility criteria, while revisiting the conditions attached. The details of this part of the reform are yet to be discussed.

At Meseberg, France also aligned itself with the German desire to give the ESM a larger role in defining conditions attached to any potential future programme, and evaluating the overall economic health of member states. These functions are currently devolved to the European Commission, which has been accused of being too lax on occasion by the German finance minister.

Yet more evidence of the gaping chasm between the countries of northern and southern Europe was apparent when France, having aligned itself with northern countries at Meseberg, brought attention to the introduction of simplified “collective action clauses”[3] for sovereign debts. The result would be to increase, for certain creditors, the risk of having to accept a partial default during a crisis. At the same time, this should facilitate restructuring of debt if support is granted by the ESM, and to better account for the debt’s sustainability. While this disposition makes it easier to ensure that the private sector intervenes in the resolution of sovereign debt, it also gives more importance to the market when evaluating the policies of various states. It may also increase interest spreads between the virtuous states and the others. According to some, this approach could have a disciplinary effect on those tempted by a budgetary adventure[4]. However, the increase of interest rates in some countries would first make it harder to reach debt-reducing objectives without inciting “virtuous” states to support demand or reduce internal inequalities in the eurozone[5].

In any case, heads of state agreed to revisit the issue at the end of the year and invited finance ministers to continue their efforts. Although the French position seemed to match that of northern European countries after Meseberg, the issue is not yet closed, notably due to the chasm between northern and southern countries and the unpredictability of the new Italian government’s position.

The eurozone budget and the additional suggestion for an automatic stabiliser

Two ideas that have long been pushed by France can be found in the Meseberg agreement: a budget for the eurozone, and what is known as an “automatic stabiliser”. This is an extra capacity to preserve the levels of certain spending if revenue is hit by cyclical weakening. The conclusions of the European Council of 29 June, however, made no mention of these two ideas, unlike the ESM reform.

The eurozone budget (not quantified at Meseberg) would be used to finance investments that support “competitiveness and convergence” which could replace national investments. In an interview before Meseberg, German chancellor Angela Merkel suggested a budget “in the lower double-digit billions”[6]. In the end, the proposition resembles the European Commission’s proposition for midterm (2021-2027) financial perspectives for a budget of €25 billion over seven years (or 0.03% of the eurozone’s GDP and 0.02% of the EU’s GDP per year!) whose aim is to support reform in eurozone countries and those preparing to join the bloc. The Meseberg and European Commission propositions have one thing in common: the symbolic character of their total figures, which even the Élysée’s PR staff don’t dare to deny. They do, however, differ greatly when it comes to governance. According to the European Commission’s proposition, budget decisions and execution are subject to supervision and control by the European Parliament. According to the Meseberg declaration, strategic guidelines affecting the budget of the eurozone would be taken by “eurozone member states”. In other words, Eurogroup – the informal meetings of the finance ministers of the eurozone

[3] A collective action clause (CAC) allows the restructuration of a debt without the consent of all creditor(s), subject to the agreement a qualified majority vote of creditors agree (generally 75%).
[4] https://abonnes.lemonde.fr/idees/article/2018/06/09/mieux-vaudrait-laisser-les-gouvernements-libres-de-tenter-les-politiques-de-leur-choix_5312185_3232.html?xtmc=&xtcr=2
[5] The example often quoted in this context is that of the United States of America, where states can be declared bankrupt, as Federal authorities have the fiscal and budgetary autonomy necessary to provide the essential safety net to the most vulnerable and, therefore, partially compensate the effects of a state failure.
[6] http://institutdelors.eu/wp-content/uploads/2018/06/20180606_Blog-Post-Merkel-on-Europe-Decryption_Koenig-Guttenberg-Rasche.pdf

– would make declarations that would then be executed by the European Commission[7]. We are still very far from the "common minister and exacting parliamentary control" suggested in President Macron's Sorbonne speech. Neither of these propositions garnered political support at the European Council in June, which was a huge setback for both the Franco-German partnership and the European Commission.

The other proposal to come from the Franco-German declaration was one of an "automatic demand stabiliser". The proposed instrument would be an "Unemployment Stabilisation Fund" to be used as a repayable loan, and would enable countries to preserve unemployment benefits during economic downturns (a similar mechanism exists in the USA). Given the various unemployment rates and different legislation relating to employment protection and employment benefits, it's easy to imagine the interminable north/south discussions between finance ministers on the necessary reduction of risks and the harmonisation of rules before the creation of this unemployment fund. The consequence would be very similar to the deadlock facing the Common Insurance Fund for the protection of bank deposits.

In any event, it is unlikely that this project for new instruments in the eurozone will materialise any time in the near future, at least not in the form suggested at Meseberg. A group of northern countries lead by the Netherlands[8] is vehemently opposed to it. Germany along with allies and the European Commission, believes that any future discussions should be carried out alongside discussions on midterm financial perspectives (2021-2027), once again pushing the issue back to a later date.

2. The dangers of "nowhere"

The Frankfurter Allgemeine Zeitung columnist is right on this point. Meseberg and the last European Council have lead nowhere, or at least not too far, and not in the right direction. There remain critical flaws in the economic governance of the eurozone. Most of these flaws are the result of a de-politicisation of the managing of banking crises and sovereign debts, the institutionalisation of precedence of creditor countries when deciding on economic policy, and a growing risk of conflict between the will of national electorates and economic policy decisions taken by the EU.

The de-politicisation of the management and prevention of banking crises is a direct consequence of a greater confidence put in markets to appreciate risks and accept consequences (bail-in). It also makes them more technocratic through the transfer of their management to the ECB, the Single Resolution Board, and, as is currently being discussed, the ESM as a last resort. The principle that favours calling upon the shareholders and creditors, rather than taxpayers in the case of a bank failure, is a welcome one. It is, however, important to have in mind that the resolution of a banking crisis, whether it is limited to individual institutes or generalised, always has redistribution effects on debtors and creditors, and economic activities. The banking system of each country is a **public service** (payment, intermediation between saving and credit for the economy and the public sector) whose added value far exceeds its financial profitability. This function is inseparable from the country and its institutional context. Therefore, the consequences of the resolution of a banking crisis on

[7] No explanation was given as to whether the European Commission would act within its mandate of implementing the union's budget, in other words under the supervision of the European Parliament, or under the collective supervision of the finance ministers
[8] https://www.reuters.com/article/us-eurozone-reform-north/northern-eu-states-urge-caution-in-euro-reforms-idUSKCN1GI0CV"

social cohesion and economic activity concern both European and national authorities differently. Only the national authorities currently have the fiscal and budgetary autonomy to allow them to preserve social cohesion and economic activities, yet the terms of the resolution are decided at a European level by agencies. In addition to this, increasing Europeanisation and the complexity of the subject mean that it tends to be left out of national democratic debates. The type of governance to which the union is steering itself is founded on the illusion that Europe could sustainably prevent and manage financial crises in a politically sustainable way without having huge budgetary autonomy at its disposal to enable it to accommodate the social and economic consequences (as the Obama administration managed to do in 2009 with a stimulus plan worth 5 to 6% of GDP). In reality, an inseparable link remains between finance and politics[9]. Taking it fully into account requires a substantial increase of European budgetary capacity, combined with governance that is capable of decoupling itself from national contingencies in order to manage cross-border bank failures.

This means that the governance of the ESM is strictly intergovernmental. Its financial investment decisions are subject to national constitutional provisions, and, therefore, to the approval of certain national parliaments, including the Bundestag. As experience has shown, this governance strengthens creditor countries and skews the process against the populations of deficit countries. This governance leads to the question of democratisation of the eurozone, particularly with regards to the collective responsibility of the Eurogroup finance ministers or the ESM Committee of Governors. The decisions they make affect 340 million people, yet each minister only answers to his or her own national parliament. This skews the cooperation process, which will then produce sub-optimal solutions to the detriment of deficit countries. National authorities – which report to their national parliaments – rarely take into account, especially in times of crisis, the impact of their actions on neighbouring countries. Three MEPs from the European Parliament's Progressive Alliance of Socialists and Democrats group have proposed a transformation of the ESM, along with its incorporation into European legislation, which would seek to share governance and mitigate its faults[10]. What is clear is that this is far from the direction in which things are currently moving, as the prevailing attitude is still one of "every country for itself".

Furthermore, discussions on the creation of new instruments of economic policy have hidden the real heart of the issue: the paradigm that underlies the coordination of national economic and budgetary policies. These policies matter[11] for determining revenues, employment and the internal inequalities of the eurozone. An analysis of the faults of this paradigm would go beyond the scope of this article. It is, however, important to note that it leaves little space for social objectives and tackling inequality, which are considered by most to be addressed at the national level. The capacity to act at said national level, however, is obliterated by the fiscal and social race to the bottom at a European level. What's more, adjustment efforts that the paradigm imposes are unbalanced. Surplus countries are given more choice when choosing their strategy, which leads to more and more extravagant external surpluses for these countries.

Admittedly, the "politicisation" of macroeconomic policy coordination and giving multilateral supervision of national budgets more flexibility through the Stability and Growth Pact have been priorities for the Juncker Commission, which set itself apart from the rigid approach of the Barroso Commission. Unfortunately that came with a price, in the form of more complexity when evaluating policies (the VADEMECUM aimed at "experts" to explain the mechanics of the page is over 200 pages

[9] See Dani Rodrik, Does Europe really need a fiscal and political union https://www.socialeurope.eu/europe-really-need-fiscal-political-union
[10] https://www.pervencheberes.fr/?p=11518
[11] The union's budget spending represents 1% of GDP, national public spending represents, on average, 46% of GDP.

long). Above all, "reforms necessary to guarantee sustainable public finances" led to more and more European intrusion in economic and social policies on which voters judge their national governments.

Finally, with the discussions focussing on the instruments of macroeconomic policy and their governance, there is a real risk of not debating the evolution of European regulation, which is critical to the fight against inequality. Social regulation and trade policy naturally spring to mind, but other initiatives deserve our attention too. Some noise is already being made in some corners of the European Commission about "excessive financial regulation", just as Donald Trump's administration has relaunched a "race to the bottom" in this domain[12]. Another example is the European Commission's recent proposal to ease the fusion, separation and transfer of companies within the single market[13], which is weak, if not non-existent, when it comes to the strengthening of workers' rights[14].

3. Conclusion

We shouldn't let ourselves be fooled by the grand speeches of "Mr Europe" Emmanuel Macron. They have been buried beneath the reality of national self-interest. In the current climate, the biggest mistake would be to let ourselves become trapped in an intergovernmental debate whose terms are dictated by finance ministers steered by their national treasuries. They will argue amongst themselves about the balance of risks and costs that stabilising the eurozone will bring to their own public finances, or about the opportunity to create a new budgetary instrument, whose symbolic nature is clear to everybody. But none of that will reconcile European working classes with the European project of integration, nor will it do anything to slow the rise of anti-European movements. Confidence will only return when social issues like the fight against inequality and insecurity, have once again become the priority[15].

It remains essential to promote a community approach and to oppose the consolidation of intergovernmental governance as it favours creditor countries. The strengthening of community intervention instruments, symbols of European solidarity, must also continue. But the key to moving the creation of an economic and monetary union out of this impasse is to change the paradigm that steers the coordination of economic policies. A good first move would be to take on board the concerns of two respected international institutions. The IMF advised that Germany and the Netherlands – the only two countries it mentioned in its most recent recommendations for the eurozone – increase their public investments and promote greater wage increases. In its first report on employment, the OECD spoke of its concern that wage stagnation in OECD countries would call into question the bloc's (incidentally rather weak) economic revival. Evidently this will not be enough to establish the foundation of a social union. The effort to reshape a left-wing, pro-European voice, is seeing three points of reflection beginning to emerge: how do we view the current social situation in Europe, focussing on what the most vulnerable have in common, wherever they might live[16]? How

[12] The Director General of the DG in charge of financial markets, Olivier Guersent, declared during a conference on 23 May that "Brussels should concentrate on the implementation of what already exists rather than new legislation"
[13] http://europa.eu/rapid/press-release_MEMO-18-3509_en.htm
[14] https://www.socialeurope.eu/old-fashioned-and-unfair-internal-market-policy-revisited
[15] While the League, the extreme-right governing party in Italy, campaigned primarily on issues of migration, its coalition partners the 5 Star Movement attracted votes by focussing on social issues.
[16] For an approach of this kind, see C. Hugrée, E. Penissat et A. Spire, 2017, Les classes sociales en Europe, Tableau des nouvelles inégalités sur le vieux continent, Agone (Ed .) et une fiche de lecture afférente : https://ollivierbodin.wordpress.com/2018/06/19/les-classes-sociales-en-europe-une-fiche-de-lecture/

responsible are European economic and social policies for the widening of inequalities (including the responsibility of things other than policies, and fiscal and social non-harmonisation) and which European instruments can be mobilised for this cause? And finally, what alliances can be made and mobilised to this effect?