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# Towards a Reform of E(M)U

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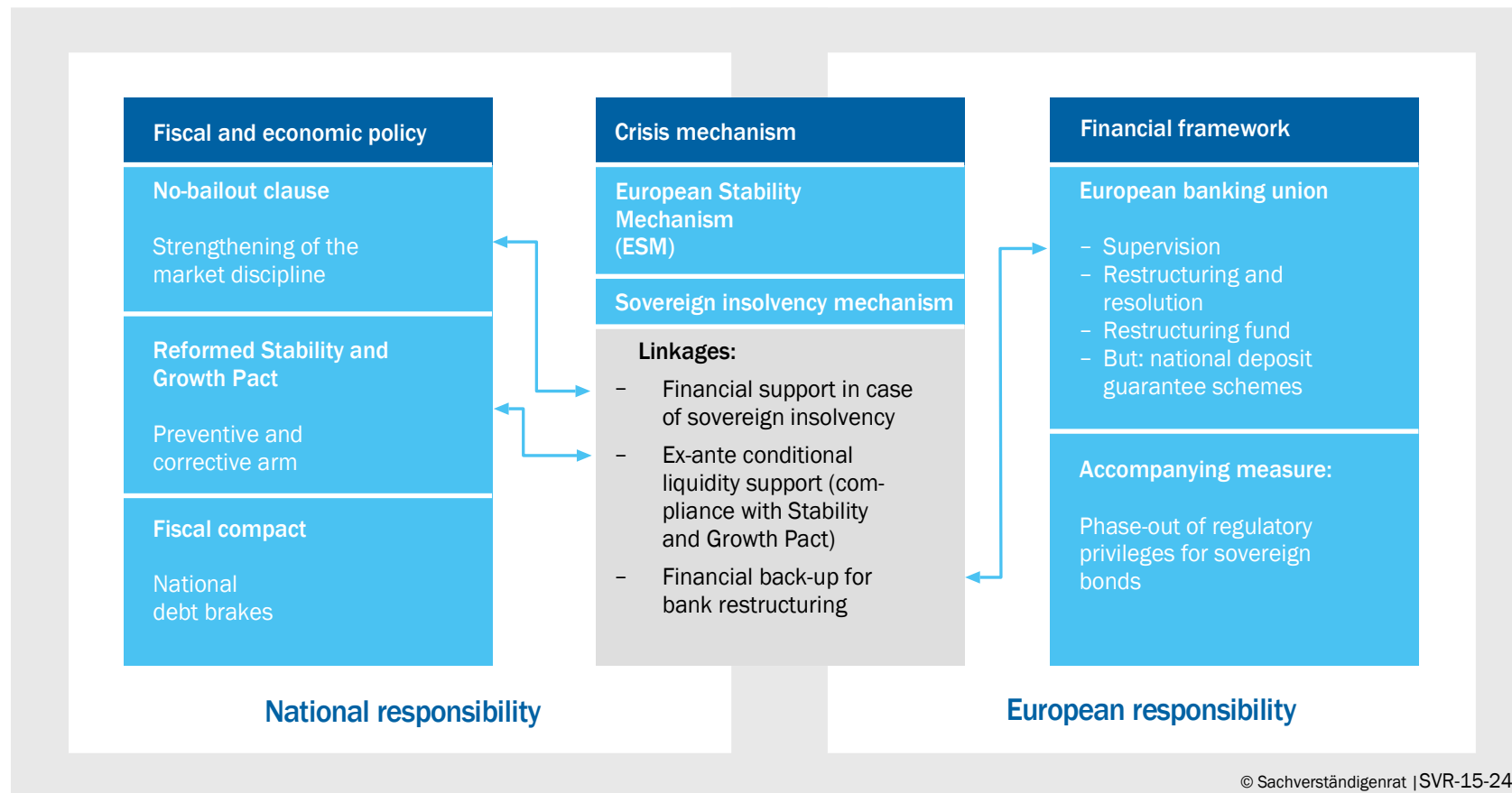
Prof. Dr. Dr. h.c. Lars P. Feld

University of Freiburg and Walter Eucken Institut

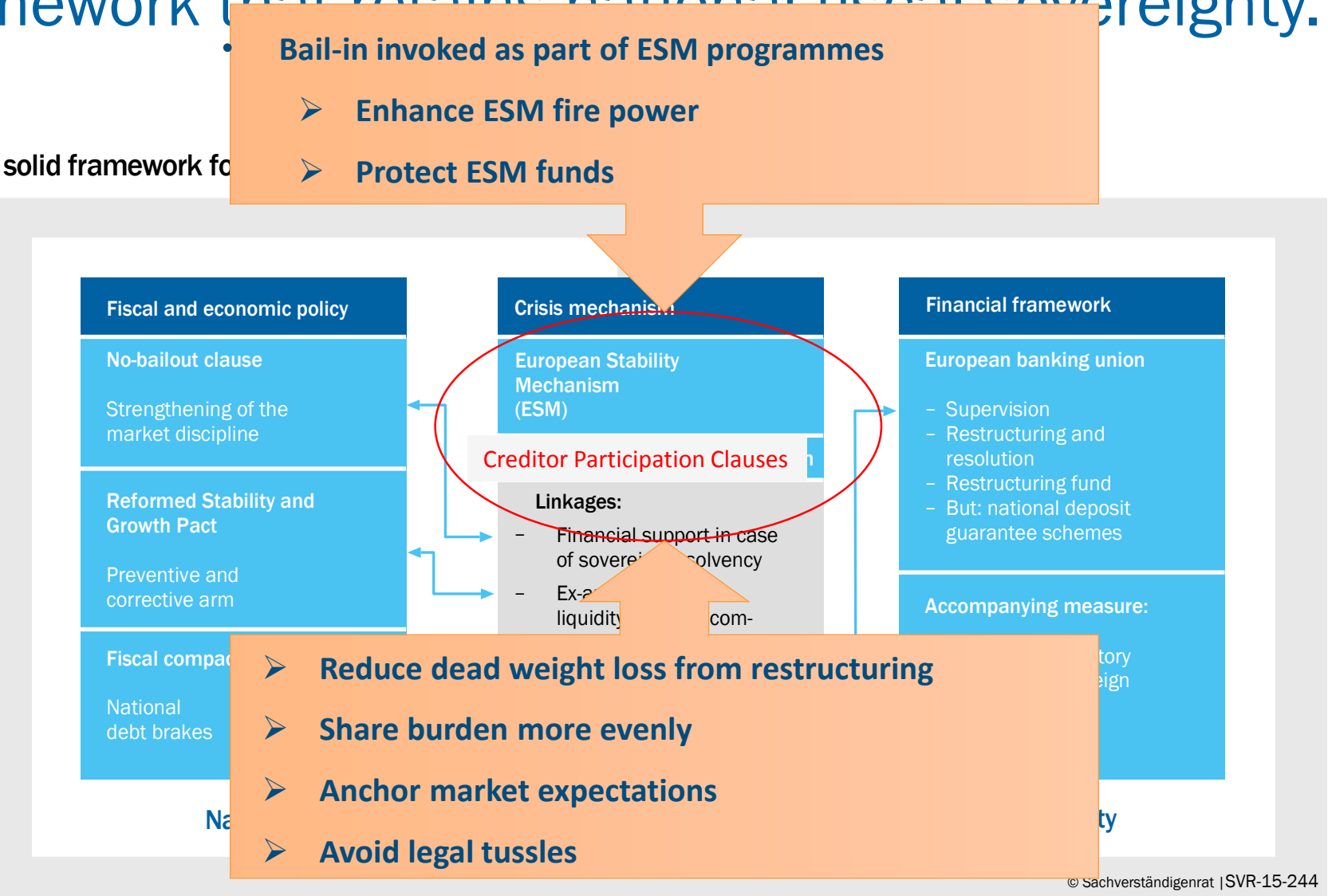
ECB Watchers, Frankfurt, 14th March 2018

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# GCEE proposal „Maastricht 2.0“ : Necessary elements for a stable framework that retains national fiscal sovereignty.



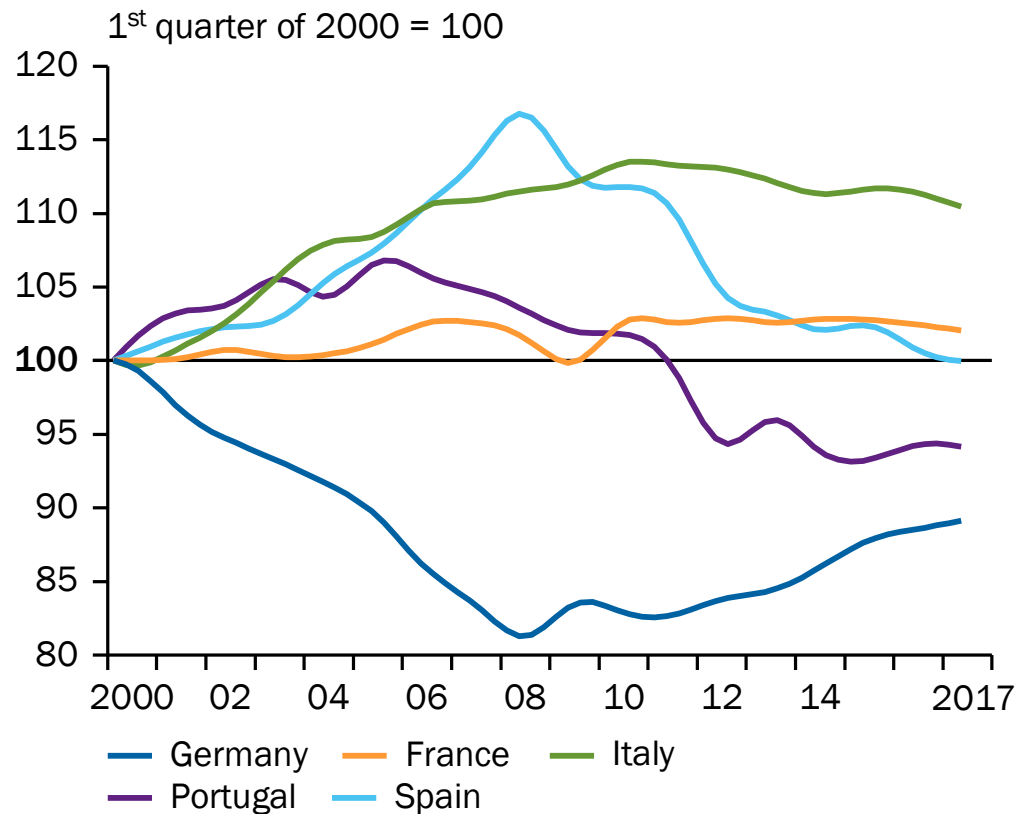
# GCEE proposal „Maastricht 2.0“ : Necessary elements for a stable framework that retains national fiscal sovereignty.



# Convergence in the euro area

## Real effective exchange rates

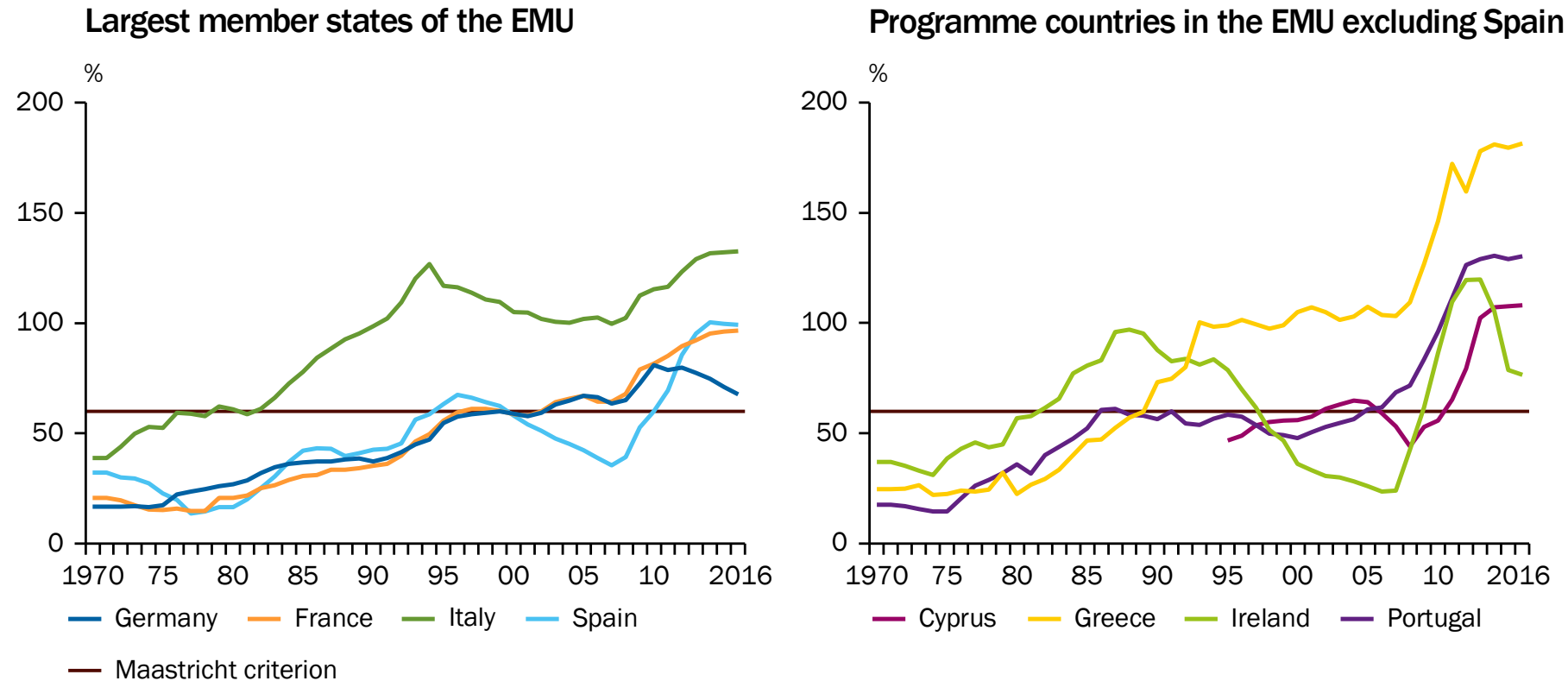
vis-a-vis the euro area



Sources: European Commission, own calculations

- Differences in competitiveness in different member states still existent
- Structural reforms to increase productivity
  - Particularly in good times
- Responsibility of national governments

# High public debt ratios in the euro area



Sources: IMF, Mauro et al. (2015), own calculations

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- Almost all member states comply with the 3 % deficit Maastricht limit by now
- But: Public debt ratios exceed the 60 % limit in 13 of 19 member states in 2016

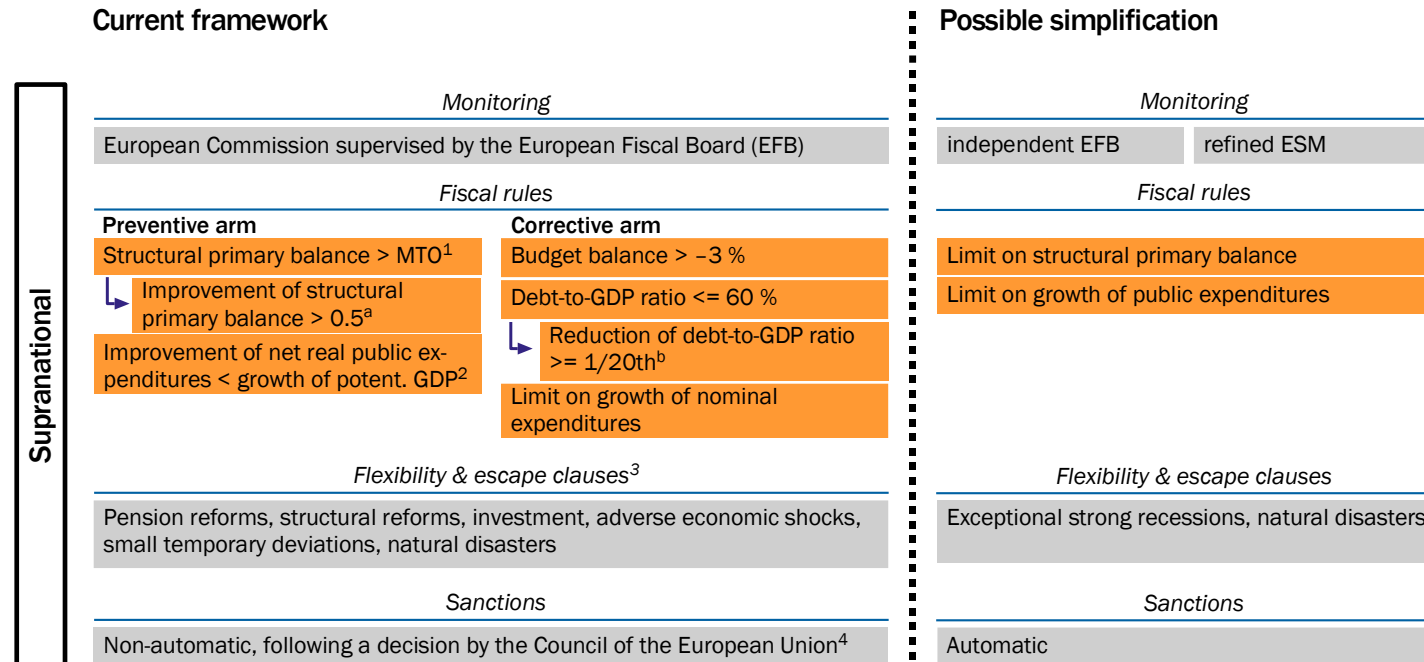
# Priority for sound fiscal policy

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- Euro area fiscal stance must not interfere with national fiscal policy
  - Relatively low spillovers
  - Risk of overheating in member states like Germany
  - Macroeconomic fine tuning in general problematic
- No necessity of a joint fiscal capacity or other fiscal equalisation schemes
  - Separation of structural and cyclical effects in real time difficult
  - Stabilisation through national fiscal policy and the ESM as last resort
  - More risk sharing through capital markets by strengthening the Capital Markets Union

# Reducing the complexity of fiscal rules

Schematic representation of the fiscal rule framework of the euro area



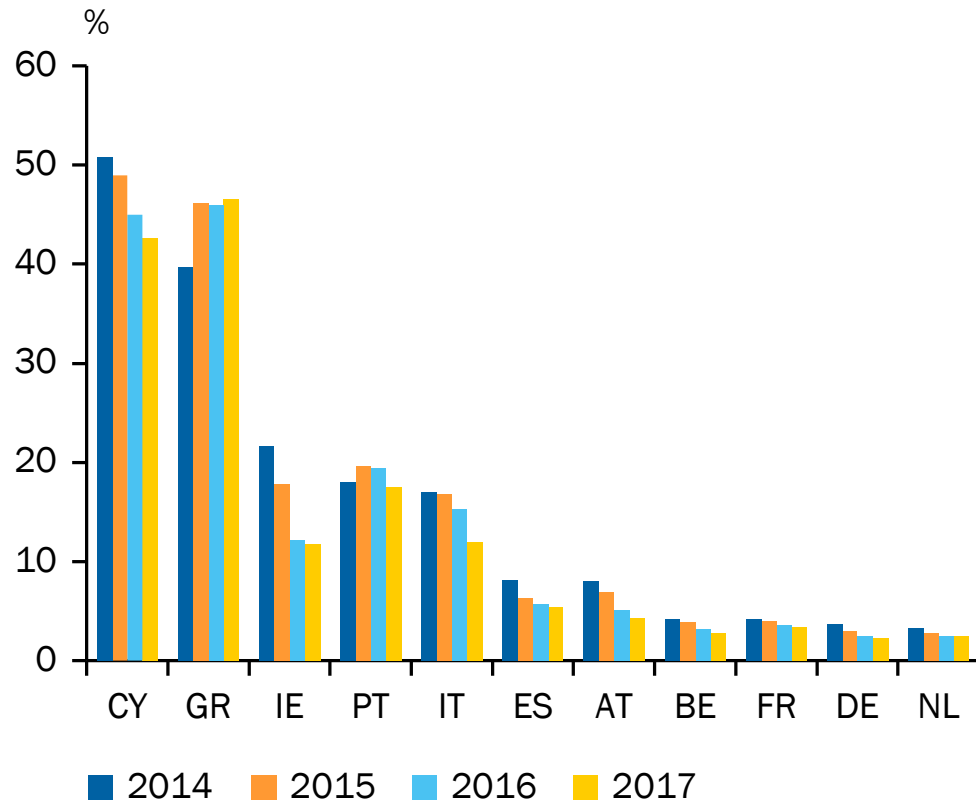
Source: Own representation

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- Simplification via two rules: Expenditure rule as annual objective and structural deficit rule as medium-term objective
- Fewer exceptions, automatic triggering of corrective measures and sanctions
- Independent surveillance through European Fiscal Board or ESM

# Completion of the Banking & Capital Markets Unions

## Non-performing loans



Source: European Banking Authority (EBA)

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- More risk sharing only after risk reduction
1. Accelerated reduction of NPL
    - Stronger supervisory targets
    - No public bad bank
  2. Single Resolution Mechanism: close gaps
    - Higher hurdles for exceptions from creditor bail-in
    - Harmonisation of national insolvency frameworks
  3. Reduce sovereign-bank nexus
    - Phase out regulatory privileges for sovereign debt in banking regulation



# Strengthening the ESM, creation of „safe assets“ only under strict conditions

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- ESM as key element of the euro area architecture
- Enhancing the ESM
  - Rules for orderly restructuring of sovereign debt in case of crises
  - Mandate for monitoring fiscal policies of member states
  - In the medium term: fiscal backstop for the Single Resolution Fund
- Creation of „safe assets“ in the euro area only under strict conditions to prevent implicit liability risks
  - Issuance through private intermediaries, ending regulatory privileges for sovereign debt
  - Intermediate step: Remove regulatory bias against securitisations

# Principles for a stable European Union

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- Well calibrated balance between national and common responsibility
- Safeguarding the principles of subsidiarity and the unity of liability and control
  - Preventing misalignment of incentives
  - Increasing acceptance for European integration

# Constructive development of the EU

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- Strengthen European responsibility in selected areas
  - Foreign trade, digital internal market, procurement in defence, migration and asylum, climate protection, counterterrorism
- But:
  - No general barriers to foreign direct investments
  - Tightening of Posted Workers Directive inhibits trade in services
  - New priorities for the EU budget
- One-time extension of negotiations to prevent disorderly Brexit

# Thank you!

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