BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

CEPS Forum: Reconstructing the Union

EMU governance: a reality check

Address by Dr Mario Vella
Governor of the Central Bank of Malta

Brussels, 23 February 2017

The Five Presidents' Report on Completing Europe's Economic and Monetary Union argues that economic and political convergence underpinning EMU needs to go deeper if it is to ensure prosperity for all its members and fairer outcome for its citizens.

In the first phase, which was meant to be completed in June, the report envisages a number of steps including:

- a new boost to convergence, employment and growth, through the creation of a euro area system of competitiveness authorities and stronger implementation of the Macroeconomic Imbalance Procedure;
- the completion of the banking union and the launch of the capital markets union;
- the establishment of a new advisory European Fiscal Board;
- a reorganisation of the European Semester, with greater parliamentary control and accountability.

The Commission should soon be publishing a related White Paper on the future of Europe.

Before moving forward, let's see what's been achieved so far. In the twenty-five years since the Maastricht Treaty was signed, the euro has been established a successful currency. It is widely accepted as a medium of exchange and store of value, not only within the euro area itself, but also beyond it. It enjoys popular acceptance and support. Although the process of financial integration in the euro area was heavily disrupted in the aftermath of the global financial crisis in 2008 and the sovereign debt crisis in the euro area in 2011, the single currency area has held together. These gains should not be lightly discarded.

But the double shock of the financial crisis and the subsequent fiscal crisis has hit EMU hard. The euro area economy is currently in a moderate, gradual recovery that has been under way since the second quarter of 2013. However, in some member states that were hit the hardest by the sovereign debt crisis, output remains considerably below the levels registered in 2008. Unemployment rates diverge considerably across the euro area, ranging from over 20% in Greece to below 4% in Germany.

The euro area is facing pressure along four different fault lines. First, there is the tension between euro area member states that are in different cyclical and, in some cases, secular positions and yet face the same nominal interest rate and exchange rate. Second, there is the related tension between monetary policy that is determined at the level of the euro area as a whole and fiscal policy which has remained, in effect, largely national. Third, there are tensions that arise from the fact that the single currency is embedded in an incomplete single market, including only a partial banking union. Finally, at the institutional level, there is the tension between the nation state and supra-national bodies that partly stems from the fact that the euro area is a monetary union which is not under-pinned by a common Treasury.

These tensions are reflected in the rise of political movements and parties that oppose and want to reverse the admittedly complex and difficult process of European integration that emerged from the ashes of the Second World War, and threaten the single currency itself. These tensions are the source of the governance issues that EMU faces and which still have to be resolved.

I would like to examine three aspects of EMU in turn: monetary policy, fiscal policy and economic integration.

I believe that as far as the monetary dimension of EMU is concerned, many issues have been settled. The Governing Council of the ECB pursues a clear mandate to maintain price stability, defined as a rate of inflation below but close to 2%, and it has consistently run monetary policy in pursuit of this goal. However, monetary policy is facing the constraints of operating at the zero interest rate bound. An institutional set-up that was designed to fight inflation has had to react to an unprecedented situation characterised by the absence of inflationary pressures. In my view, some design features – such as the asymmetric response to deviations from the ECB’s target – ought to be reviewed.

On the fiscal front, compliance with the existing governance framework has fallen far short of the original expectations. Initiatives to strengthen the rules and the related institutional framework, such as the establishment of national fiscal councils and the European Fiscal Board are helpful. But they are probably insufficient.

It is my contention that we will not resolve problems related to fiscal governance in the euro area solely by adjusting the rules and strengthening the institutional set-up.

The Five President's Report moves in the direction of a single fiscal policy, with a euro area wide budget that is large enough to contain in-built automatic stabilising mechanisms that allow for a transfer of resources from those regions in the euro area that are doing relatively well to other regions that have been hit by adverse shocks. But if the will to abide by the existing rules was weak, there seems to be even less appetite for further integration on these lines. On another view, one could recognise that events have shown that fiscal policy remains a vital shock absorber at the national level and that, therefore, it may be necessary to increase, rather than reduce, flexibility in the conduct of fiscal policy.

Given that the objective of a common fiscal policy and a common Treasury remains politically unrealisable, one needs to explore other interim solutions which, without creating risks of moral hazard, introduce an element of solidarity between EMU members that go beyond bail-outs and austerity. In the end there can be no longevity in a monetary union where members are moving at very different economic tempos and sometimes even in different directions.

Another aspect of EMU governance is strengthening the economic part of EMU. This requires structural reforms aimed at enhancing potential growth, reducing structural unemployment and increasing national economies' resistance to shocks. While many euro area countries undertook a wave of reforms during the crisis, today, across much of the area reforms have stalled. This is not a uniform picture. Malta is enjoying robust economic growth despite regional headwinds, largely as a result of reforms implemented in recent years that stimulated the development of new areas of economic activity and increased labour participation. Malta has also taken full advantage of its membership of the EU and its adoption of the single currency.

Resilience to shocks can also be built up through deeper economic integration. Indeed, as the Five Presidents' report argues, financial integration helps to share risk across EMU member countries. The completion of a Banking Union, which will strengthen the European banking sector, is a key objective in this regard. In this area, success so far has been partial. The Single Supervisory Mechanism involving the ECB via the Supervisory Board and the national supervisory authorities is up and running, following a comprehensive health check of the euro area banks. The Single Resolution Mechanism is also operational and is being funded according to plan. As regards the third pillar of Banking Union, the European Deposit Insurance Scheme (EDIS), negotiations are still under way. We believe that EDIS is will increase confidence in banks across the euro area.

In sum, we are still far from completing the steps envisaged in the first phase of the Five Presidents' roadmap. Achieving and maintaining responsible fiscal policies at national and euro area level still seems beyond our grasp and while certain elements of the Banking Union are now in place, more needs to be done. Overall, the timetable is ambitious. We must also be realistic and admit that further integration is running against headwinds of popular discontent with integration and liberalisation.

We need, therefore to be more open about what we are doing, to fully engage all our citizens and to build a case for a stronger EMU that can enjoy broad popular consensus rather than being imposed from above.