Yves Mersch: Competitiveness of Europe and European financial markets

Panel contribution by Mr Yves Mersch, Member of the Executive Board of the European Central Bank, at the 30th edition of the workshop "The Outlook for the Economy and Finance", Villa d'Este, Cernobbio, 6 April 2019.

* * *

To increase competitiveness is the main driver for higher potential growth. Member states have to pursue politics and establish institutions that stimulate the dynamics of a competitive private sector.

In most euro area countries potential growth has remained too low, however. Labour market rigidities and inefficient business environment conditions seem to be major impediments. In particular, labour supply is held back by policies which do not sufficiently motivate to take up jobs and do not tackle skill mismatch or labour shortages. Moreover, investment could be strengthened through fostering competition, improve the business environment and reduce uncertainty e.g. through improving the quality and efficiency of public institutions more generally.

Despite favourable economic and financing conditions, structural reform progress has been rather limited, including in several of the weakest countries.

The trend of insufficient structural reform implementation observed in particular since 2014 has continued during the last year. Only a few countries have engaged in more far-reaching structural reforms, most notably Greece and France. Some countries even reversed recent reforms that had been designed to improve the smooth functioning of the economy, most notably in the areas of labour markets and pension systems. Overall, reform efforts were not in line with reform needs.

These policy areas concern national competencies, but in a single markets cross-border spill-over effects are generated. Governments therefore need to act at national levels, enhanced through procedures, rules and harmonization at EU level.

Against the background of limited reform effort and in spite of the robust cyclical upswing, overall risks and vulnerabilities in many cases have only moderately declined since last year.

The Commission's annual assessment of country specific recommended reforms finds only limited progress.[1]

The progress made is evaluated using five categories: "no progress", "limited progress", "some progress", "substantial progress" and "full implementation". "No progress" means that the Member State concerned did not even "credibly announce" measures that would aim to address the policy recommendation.

Out of 73 country specific recommendations (CSRs), none saw full implementation, and substantial progress was made in only two cases. For the overwhelming majority of CSRs (more than 90%), the Commission found that Member States made at best some or limited progress. On two CSRs, no progress was made. Most concerning, despite being very vulnerable, the countries experiencing excessive imbalances did not make significantly more reform progress during the last year than the EU average. The same is true for the countries experiencing imbalances. Overall, progress on reforms this year was as weak as last year.

The international role of the euro

But also on the European level there is not only a role to harmonize national action in order to reap the benefits of the Single Market. Where competence has been transferred to the EU level, the need to spur competitiveness is at the EU level.

The European Commission presented a set of action points to strengthen the euro's global role. More recently, the COM has underscored the increasing relevance of capital markets union in supporting the international role of the euro amid geopolitical changes (e.g. Brexit and US foreign and trade policy).

To this end, the euro should become even more compelling as a means of payment and a trustworthy investment currency. Without prejudice to the ECB's independence, we took note of the Commission's support for our initiatives on market infrastructure and payments, which help to increase efficiency and financial market integration in the euro area.

International trade

It was important to resist, the temptation to gain competitive advantage or create national champions by tilting the system in one's favour (e.g. in the area of tax, privacy, cyber security and fintech policies).

The costs of fragmentation of global trade would be high. IMF staff simulations of a global trading system that had been fragmented into three trading blocs show that in such a scenario, each of the blocs was overall worse off, although individual countries within the bloc may actually gain. These issues would also apply to other areas like the international flow of data and access to the global payments system.

There are five dimensions where progress is needed:

1. consensus on how to address social and economic grievances;
2. a rethinking of the appropriate mix of domestic policies;
3. strengthening and updating of the international rules of the game;
4. adequate management of global public goods;
5. securing the global financial safety net.

Payments systems

The ECB's responsibility for promoting the smooth operation of payment systems indirectly supports the international standing of the euro. The Eurosystem has contributed to reshaping and consolidating the infrastructure for large-value payments, for post-trading services for financial instruments and, most recently, for instant retail payments.

Over the next two or three years we aim at

- taking measures to **consolidate TARGET2 and TARGET2-Securities (T2S**), in particular by delivering a centralised liquidity management function;
- developing a **single collateral management system** that will be capable of managing the assets used as collateral in Eurosystem credit operations for all euro area countries.

Harmonization agenda

More harmonization is necessary to achieve a safe and efficient European post trade landscape. The *European Post Trade Forum* (EPTF) Report identifies barriers which have not yet been dismantled (formerly known as "Giovannini Barriers"), as well as new bottlenecks which need to be addressed to promote more efficient and resilient market infrastructures in the EU. These include:

- Inefficient withholding tax collection procedures
- Legal inconsistencies and uncertainties
- Fragmented corporate actions and general meeting processes

More harmonisation of national insolvency rules is needed to make European resolution more effective. The recently agreed proposal (December 2018) is a minimum harmonization directive allowing member states to go further when transposing the rules into national law.

European issuance

- An important element in a well-functioning capital market is the smooth interplay between issuance on the primary market, investors and secondary markets. In Europe, the issuance and distribution of securities is still complex and operational cost are elevated. Securities are still issued along different national rules, standards and habits.
- Central Securities Depositories (CSD) play a pivotal role in this process. Today, issuers usually issue in one CSD. All other CSDs, and their national customer base, need to access these securities by connecting to this initial one. This chopped-up process is complex and relatively expensive. Investors and issuers alike see scope for improvements.

---

[1] The progress made is evaluated using five categories: “no progress”, “limited progress”, “some progress”, “substantial progress” and “full implementation”. “No progress” means that the Member State concerned did not even “credibly announce” measures that would aim to address the policy recommendation.