Yves Mersch: European economic governance - early lessons from the crisis

Keynote speech by Mr Yves Mersch, Member of the Executive Board of the European Central Bank and Vice-Chair of the Supervisory Board of the European Central Bank, at the Conference "The Werner Report, 50 Years on", organised by the Luxembourg Centre for Contemporary and Digital History in cooperation with EUI, 8 October, 2020.

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Introduction

In my remarks today, I will focus on three elements which I believe could outlast the EU crisis response – and could perhaps form Pierre Werner's legacy.

A substantial crisis response at European and national level with a threefold legacy

Europe's historic response to today's unprecedented crisis not only coincides with the 50th anniversary of the Werner Report. It also puts the report's economic reasoning into practice.

In Werner's view, monetary integration had to be accompanied by a partial Europeanisation of fiscal policy. Such Europeanisation does not necessarily imply full harmonisation. As set out in the Treaty on the Functioning of the European Union, it means that countries coordinate and conduct their national economic and fiscal policies in a manner that contributes to maintaining the stability of the EU as a whole.

The policy responses to the pandemic respect these principles and hold important lessons for the future.

The European-level response has been substantial. The ECB has taken far-reaching exceptional monetary policy decisions. The pandemic emergency purchase programme, targeted longer-term refinancing operations, and pandemic emergency longer-term refinancing operations have provided over €2 trillion in liquidity since March – and we also decided on changes in the collateral framework. We estimate that, by the end of 2022, all of these measures will have increased real GDP growth in the euro area by around 1.3 percentage points and inflation by around 0.8 percentage point. Our crisis-related supervisory decisions are freeing up some €120 billion of bank capital which could be used to absorb losses or potentially finance up to €1.8 trillion of lending.

The European Commission and the Member States in the Council took decisive measures to support national governments, firms and workers, helping to cushion the immediate impact of the crisis (especially through three safety nets, namely the European Stability Mechanism Pandemic Crisis Support instrument, the European Investment Bank pan-European Guarantee Fund and the European instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE), which together amount to up to €540 billion in loans.

Moreover, in late July, the European Council agreed on a recovery plan to secure a more even and sustained recovery across EU economies (comprising a frontloaded multiannual financial framework for the years 2021–27, reinforced by a €750 billion recovery fund raised through common borrowing).

Although these measures have yet to be implemented, they have had a crucial impact on the markets.

In line with the EU's institutional framework, national governments have done most of the initial heavy lifting. Euro area governments have so far adopted measures worth about 4.5% of GDP and loan guarantees equivalent to another 20% of GDP.

Ad hoc fiscal reinsurance

I see the historic nature of the EU response not in the sheer size of EU spending – which is indeed unprecedented –but rather in the organisation of governance in Europe. For the first time in its history, the EU is taking on common debt to help finance a recovery.

Some might see this as establishing a precedent enabling the EU to issue debt in potential future crises. But this does not mean that outside of crisis times and the 2021–27 multiannual financial framework, common debt issuance should become the norm. The debt issuance under the recovery fund is legally designed to be temporary. While demonstrating European solidarity, it is an ad hoc fiscal reinsurance supporting national governments in their crisis response. It signals that fiscal policy remains largely national and subject to control by national parliaments, reflecting that budgetary policy is their key prerogative, in other words, their "Königsrecht".

New space carved out for EU policies

My second observation is that the crisis response has carved out potential new space for EU policies, an effect that is, of course, not unique to this crisis. The response to the coronavirus (COVID-19) crisis has underlined the importance of a common approach to common problems.

Take the "Next Generation EU" recovery fund which provides financing to fulfil the EU's priorities, notably the green and digital transitions, thereby helping to avoid economic divergence and to increase resilience and potential growth. The recovery fund is disbursed to national governments on condition that it is used for making commonly agreed investments and reforms. This arrangement could lay the groundwork for common EU policies in areas of collective interest which are underpinned by direct EU spending.

Against this background, I would welcome a serious discussion about EU public goods so as to identify where the case for them is strongest and how they may be in part financed through the EU budget. This is precisely what the principle of subsidiarity prescribes: policy measures should be taken at the most local levels of governance unless they can be implemented more efficiently at a more central level.

Opportunity for a clearer delineation of responsibilities

Such a debate – and this is my third observation – could also extend to a broader review of the allocation of competences across the different governance layers in our supranational community. Clarity on which policies should be European would help bring clarity on what should be kept national, allowing Europe and its Member States to establish a greater sense of the necessary alignment of liability and responsibility across the different layers of government.

The quality of governance at the relevant responsibility level would benefit in three ways. First, a clearer delineation of responsibility could lead to better economic outcomes, as policies that have been designated as a national competence can then be better tailored to local circumstances. Differences in economic circumstances and institutional settings, as well as national preferences, can be taken into account.

Second, national sovereignty over the design of certain policies naturally allows multiple approaches to compete with each other, potentially spurring innovation and accelerating the identification of best practices.

The EU offers a unique space for such policy competition, not just because of the diversity of its Member States, but also because of its common institutional framework. To be fair and to produce welfare-enhancing outcomes, competition needs to be subject to common rules.

Positive policy competition in national domains thus needs to rely on a rules-based framework of commonly agreed boundaries such as those provided by the EU. And our framework even goes one step further: it is underpinned by supranational institutions such as the European Court of Justice. It guarantees a level playing field for all Member States, big and small, so that the best policies can succeed.

Beyond rules and institutions, another way of preventing competition from drifting into destructive rivalry is to delegate some policy areas to the EU level. I can think of several aspects of financial markets which would benefit from this kind of delegation, which – in the absence of a treaty change – would need to be taken by unanimous decision. In the fight against money laundering, for example, a European agency to supervise and coordinate country-level efforts would offer powerful support, thereby closing loopholes arising from differences in national regimes. A proper EU capital markets union would lead to deeper and more diversified sources of financing for European businesses and households. For that to happen, financial market regulation first needs to be further harmonised. However, applying the rules of civil law should not be mistaken for financial regulation .And the completion of the banking union, notably through the creation of a European deposit insurance scheme, would make the euro area banking system safer while promoting healthy competition among banks.

Third, a clearer understanding of the delineation of responsibilities between the national and EU levels would improve political accountability and legitimacy all round. This is well reflected in two important political principles identified in the Werner report. Werner argues that the degree of European integration should be proportionate to the objective, and that any transfer of power to the EU level should go hand-in-hand with a corresponding transfer of parliamentary responsibility.

So far, the political dimension of the EU's integration has been the most neglected. Shifting competences to the European level needs to be accompanied by further political integration and democratic accountability.

Ensuring that everyone plays by the same rules is an important component of our European democracy. The EU is built on the principles of equal and fair participation in economic and political life, which can only be guaranteed through strict enforcement of the rule of law.

Any shift in powers to the European level must not come at the expense of the representation of EU citizens. In particular, democratic participation at the national level cannot simply be replaced by indirect participation at the EU level. If public risk-sharing, for example, is to become a permanent feature, the roles of the European Parliament, the European Commission and the Council would have to be reviewed.

These are constitutional issues that would – if we were to go down this road – require a rethink of the fundamental structure of the EU and would ultimately need to be reflected in the Treaty.

The fact that the crisis response has been designed within the EU institutional framework shows that our framework is flexible. It leaves the EU and its Member States scope to tailor policy responses to specific situations. But it also leaves a grey area of blurred responsibilities between the national and EU level. This ambiguity may undermine the EU's full potential.

A Treaty change, if there were appetite for one, would be an opportunity to incorporate in our common framework the tools used in the last crisis, such as the European Stability Mechanism. It could also confirm whether the instruments used in this crisis – such as the possibility to issue common debt in exceptional times – would be at the EU's disposal in the event of future adverse shocks. Moreover, a Treaty change could allow for a review of which responsibilities are national and which are European.

The envisaged Conference on the Future of Europe offers a chance to obtain people's views and input on these issues. This could help structure future debates and form a good example of how to enhance democratic accountability. Such debates should touch on issues that are especially important to people's lives, such as internal and external dimensions of security, a common border policy and a more responsive foreign policy.

Conclusion

Let me conclude.

Werner was aware that some Europeanisation of fiscal policy was an important element for the currency union. In response to the COVID-19 crisis, such Europeanisation has reached its peak in common debt issuance. Such crisis measures are justified by the pandemic, but they should not be taken beyond crisis times without parallel deepening of the institutional functioning of democracy at the Union level.

What we can and should take beyond the crisis are our common principles that have served us well, such as a common approach to common problems. And we should use this opportunity for a clearer delineation of responsibilities and competences among the different governance layers in our supranational community.

Jean Monnet famously stated "Europe will be forged in crises and will be the sum of the solutions adopted for those crises." Let's keep striving to ensure that the legacy of this crisis is a positive one.